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Vanderlip, Frank Arthur

Banking and currency

Washington

1913

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# BANKING AND CURRENCY

## HEARINGS

BEFORE THE

### COMMITTEE ON BANKING AND CURRENCY UNITED STATES SENATE

SIXTY-THIRD CONGRESS  
FIRST SESSION

ON

S. 2639

A BILL TO PROVIDE FOR THE ESTABLISHMENT OF FEDERAL RESERVE BANKS, FOR FURNISHING AN ELASTIC CURRENCY, AFFORDING MEANS OF REDISCOUNTING COMMERCIAL PAPER, AND TO ESTABLISH A MORE EFFECTIVE SUPERVISION OF BANKING IN THE UNITED STATES, AND FOR OTHER PURPOSES

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STATEMENT OF  
FRANK A. VANDERLIP  
PRESIDENT OF THE NATIONAL CITY BANK  
OF NEW YORK, N. Y.

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OCTOBER 23, 1913

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WASHINGTON  
GOVERNMENT PRINTING OFFICE  
1913

THURSDAY, OCTOBER 23, 1913.

COMMITTEE ON BANKING AND CURRENCY,  
UNITED STATES SENATE,  
*Washington, D. C.*

The committee met at 10.55 o'clock a. m.

Present: Senators O'Gorman (presiding), Hitchcock, Reed, Pomerene, Shafrroth, Hollis, Nelson, Bristow, McLean, and Weeks.

Senator O'GORMAN. Mr. Vanderlip, you may proceed. The committee will be glad to receive any further suggestions you may have to offer regarding the pending legislation.

FURTHER STATEMENT OF FRANK A. VANDERLIP, NEW YORK,  
N. Y.

COMMITTEE ON BANKING AND CURRENCY.

UNITED STATES SENATE.

ROBERT L. OWEN, Oklahoma, *Chairman.*

GILBERT M. HITCHCOCK, Nebraska.

JAMES A. O'GORMAN, New York.

JAMES A. REED, Missouri.

ATLEE POMERENE, Ohio.

JOHN F. SHAFROTH, Colorado.

HENRY F. HOLLIS, New Hampshire.

JAMES W. BELLER, *Clerk.*

II

KNUUTE NELSON, Minnesota.  
JOSEPH L. BRISTOW, Kansas.  
COE I. CRAWFORD, South Dakota.  
GEORGE P. MCLEAN, Connecticut.  
JOHN W. WEEKS, Massachusetts.

Mr. VANDERLIP. Following my previous hearing, it was suggested by some of the members of the committee that I engage my mind with the problem of whether or not a bank could be formed which would be entirely under the control of the Government, and which would be a feasible and workable institution. I have been giving my very best attention to that subject. To state the conclusion, rather than the road by which it was reached, I will say that I believe that is possible. I believe you can create an institution every officer of which will be appointed by the Government and the control of which will lie solely with these public officers, an institution in which the banks will have no word of Government whatever, and which still would be satisfactory to the banks and would be a workable plan. I shall be glad to elucidate that plan, if you wish.

Senator O'GORMAN. You may proceed.

Mr. VANDERLIP, I would suggest the granting of a charter to a Federal reserve bank, with \$100,000,000 of capital—a fixed amount of capital, not a variable amount. The head office would be located in Washington, and there would be as many branches as the governors of the bank might see fit to provide, probably starting with 12, the number of regional banks now suggested.

I would adopt the idea of the present bill in regard to the appointment, in the very first instance, of an organization committee. The function of this committee would be to divide the territory of the United States into, we will say, 12 districts, and to select one city in each of those districts which would be the seat of a branch of the Federal reserve bank.

The stock of this bank should be either entirely owned by the Government, the funds for the purpose being secured by the sale of Government bonds at the lowest interest rate at which those bonds would float, or it might be offered to the public generally, and the success of that offering insured by requiring the banks to underwrite a pro rata proportion. There would be no need of any restriction

on the purchase, sale, or accumulation of the stock; because it would have no rights whatever, except a right to receive a specified dividend. The stock would have no voting power, and no right of any character except to receive dividends and, in the event of liquidation, to receive back the amount of money that was paid in, but no accumulation of surplus, should there be any surplus—which there probably would not be—in the event of liquidation.

I would have the Government of this institution absolutely and completely in the hands of a board of seven men appointed by the President of the United States with the advice and consent of the Senate. These men would serve for terms of 14 years, the first board to be classified so that the term of office for one director would expire every second year, and thereafter appointments should be made for 14 years. There should be no ex officio appointments, but all members should be selected by the President for these terms, and there should be a clause in the act directive to the President that these appointments shall be made from men qualified for the duties, that the appointments shall in no case be made as political rewards, and that three at least of the seven should be men who have had acknowledged banking and financial experience.

Senator REED. And I suppose, Mr. Vanderlip, you would add that at the time of their appointment and during the holding of that office they should have no banking connections whatever?

Mr. VANDERLIP. Oh, absolutely.

Senator WEEERS. Stockholding or otherwise.

Mr. VANDERLIP. And that would be the case of all appointees of the bank in any official or executive capacity. They should have no relation, either official or financial, with any other existing banking institution.

I would provide that each branch be equipped with an executive committee of seven, to be appointed by the board of the Federal reserve bank, and with the same directive clause that they should be appointed for their qualifications or experience, and that at least three of the seven should have had acknowledged banking and financial experience.

The President would designate one member of the board to act as governor and one as deputy governor; and the governor, or in his absence the deputy governor, would act as chairman of the board and be the chief executive officer of the bank. In the case of the executive committee the board of the Federal reserve bank would designate a chairman and a vice chairman, and the chairman would be chairman of the board, or in his absence the vice chairman would be. The executive committee would elect officers of the branch other than themselves. The titles of the executive officers would not be president, vice president, etc., but their functions would be similar to the functions of such officers in a bank; that is, the chief executive officer's.

Senator HITCHCOCK. Who would elect those officers?

Mr. VANDERLIP. The executive committee.

Senator HITCHCOCK. The executive committee of what?

Mr. VANDERLIP. Of each bank; that is, subject to the approval of the board of the Federal reserve bank. Every act of the executive committee would at all times be subject to the approval of the Federal reserve board.

Senator NELSON. Here in Washington?

Mr. VANDERLIP. Here in Washington. That board would be supreme in every particular in the management of this institution.

Senator O'GORMAN. Will you state here, Mr. Vanderlip, why it would be necessary with a branch to have officials other than the seven governors who would be named by the reserve board?

Mr. VANDERLIP. The branches would be the active executive factors of this institution. These branches would have the right to rediscount and would rediscount commercial paper for member banks.

There should be a permanent trained banking staff, who would work under the direction, first, of the executive committee, and, in the last instance, under the board of the Federal reserve bank.

Senator HITCHCOCK. These directors would give their whole time to the service of the branch?

Mr. VANDERLIP. That should be specifically provided, that they should give it their whole time.

I should have said in regard to the stock that I would attach a double liability to it if it is sold to the public.

Senator HITCHCOCK. Would you limit the quantity that individuals might buy?

Mr. VANDERLIP. I would not, because it would not make any difference in the management if one individual owned it all he would have no influence whatever.

Senator O'GORMAN. If this entire system is to become a public utility system and is to be conducted not primarily for the purpose of private gain, and if the return to the holders of stock will be restricted to a fixed dividend rate of perhaps 5 or 6 per cent, would it be well to impose an additional liability on the holders of such stock?

Mr. VANDERLIP. On reflection, perhaps not. I probably was influenced by the present practice.

Senator O'GORMAN. Would not that discourage the public from investing in such stocks?

Mr. VANDERLIP. I think it would, yes; and be such a discouragement as would offset the benefit. I am inclined to think you are right on that.

Senator REED. Besides, Mr. Vanderlip, if this stock were sold, the best holding in the world for it would be a general holding among the people; I should think that would be the most helpful construction. And therefore it might be held in large part by people who invested their savings in it, and a double liability would not amount to much.

Mr. VANDERLIP. I quite agree with you and withdraw that suggestion.

Senator NELSON. What dividend rate would you suggest, Mr. Vanderlip, on that stock?

Mr. VANDERLIP. The lowest rate that will float the stock at par.

Now, there will be some question as to the earning capacity. Of course, the cheapest thing for the Government to do would be to sell its bonds at the lowest possible rate. It could sell \$100,000,000 of bonds at  $3\frac{1}{2}$  per cent. I doubt if it could float \$100,000,000 of stock at 5 per cent. My judgment would be, as conditions are now, that about  $5\frac{1}{2}$  per cent would be the point at which that stock would float; 6 per cent would be a little too high, and 5 per cent would be distinctly

doubtful. The rate ought to be such that the burden of underwriting the stocks which you impose on the banks would not be a serious one and would not result in the banks getting any great amount of that stock.

Senator HITCHCOCK. Would you think 5 per cent would be too low if it were made a cumulative dividend?

Mr. VANDERLIP. It should be cumulative, undoubtedly.

Senator NELSON. Do you not think a stock of that kind under those conditions would be analogous to a permanent annuity, and would it not be a popular investment for that purpose?

Mr. VANDERLIP. It would after the bank had been running a sufficient length of time to demonstrate its earning capacity, and I think there would be no doubt about its earning capacity.

Senator HITCHCOCK. What would you think of the proposition to have the Government subscribe for a part of this stock and issue bonds to pay for it until a market was found for it?

Mr. VANDERLIP. It might well be provided that the Government instead of the banks underwrite the issue. That is to say, they would offer it to the public and take what the public did not take and later sell it to the public.

Senator MCLEAN. How would it do to allot it to the highest bidder?

Mr. VANDERLIP. If you made the rate 6 per cent, I think I should allot it to the highest bidder. I would think well of the plan that was adopted when the Spanish War loan bonds were sold of allotting to the smallest subscribers first, giving as wide a distribution of this stock as you could—give it to the public; give it to the small investor first. If the public won't take it, then the banks must take it. Or we might adopt the suggestion that has been made here, and let the Government itself underwrite it, and not make a forced underwriting on the part of the banks. You must, in some way, if you launch this enterprise, insure its success. You would have to insure its success on the start by raising this money, and either the Government or the banks would have to stand ready to take what the public declined to take.

Senator WEEKS. Let me give you another thought about the double liability. Double liability presupposes the possibility of a failure. I do not think there ought to be such a possibility in this kind of bank.

Mr. VANDERLIP. I quite agree with you. I think the double liability is wrong.

Senator WEEKS. That the organization should be such that there could not be such a thing as a failure of the bank.

Senator O'GORMAN. Mr. Vanderlip, bearing upon your suggestion that the stock be underwritten by the banks, you mean by all the national banks?

Mr. VANDERLIP. By all national banks, pro rata; that is to say, in the proportion that the capital of each bank bears to the total capital of all national banks on a given day.

Senator O'GORMAN. Assuming there would be some national banks—because there would be some—not in favor of this plan, would they not be likely to protest, as they are protesting now, that this additional burden should not be placed upon them?

Mr. VANDERLIP. They would protest exactly as they are protesting now, but with less force, because they would not be obliged to make a permanent investment. They could perfectly well measure their loss, because they could sell the stock the day after they got it.

Senator O'GORMAN. Do you not think this plan would more generally invite public confidence if the banks had nothing to do with the creation of the system, leaving it to the public and the Government?

Mr. VANDERLIP. It would be most desirable if you would be willing to do that. Leave the banks out entirely; the banks will welcome that.

I should have said in regard to the appointment of the board of the Federal reserve bank that the President should distribute them geographically, so as to give due weight to commercial sections of the country; not to geographical extent but to commercial importance, and that the members of this board should be retired automatically at some age; the same age, perhaps, as the Supreme Court judges.

Senator REED. When you say they should be distributed commercially, you mean distributed so that they could meet the present or developing lines of commercial activity?

Mr. VANDERLIP. Yes, sir.

Senator BRISTOW. Mr. Vanderlip, why do you recommend 14 years as the term of service?

Mr. VANDERLIP. I regard long terms as absolutely essential to insure proper character for this board. It is through that point that I am willing to come at all to the thought of an institution entirely controlled by Government appointees. With one member retiring every two years there can then be hardly any question of partisan politics in that board. I think there is the greatest safety not only in the character of appointments, but in the ripe experience which the men would gather and in the thought that it was practically a life appointment of the very highest character that a man in finance or business could attain.

Senator NELSON. And you would get more of a continuity of practice, policy, and administration?

Mr. VANDERLIP. Yes, sir.

Senator BRISTOW. What salary would you recommend?

Mr. VANDERLIP. The very highest you are willing to pay; and any salary that is now paid by the Government to any officers other than the President would seem to me too small. I know you would find it hard to give these men salaries higher than the Supreme Court justices or Cabinet officers. Really, the minimum should be \$15,000, with probably \$17,500 for the governor.

Senator BRISTOW. Why do you suggest seven directors for the branches, the seven to devote their entire time to it, and then, outside of the seven directors, have the officers selected? It seems to me that that is a pretty big organization for a branch.

Mr. VANDERLIP. It will be a pretty big institution. It will be an extremely big institution with a tremendous amount of detail. If this institution is to carry on the exchange business—which means the collection of exchanges—that in itself will require an organization—a genius of management—of the very highest character. It will be a work of detail equal to almost any job you might think of.

Senator O'GORMAN. If I catch your meaning at this point, Mr. Vanderlip, these seven officials managing the branch, appointed by the members of the Federal reserve board, may act relatively as a board of directors does in an ordinary private institution, and they will control the action of the bank?

Mr. VANDERLIP. Yes, sir; but I would presume they would be somewhat closer to the detail work than is an ordinary board of directors. They would be more analogous to the managers of a foreign bank, that is not run by a president, but is run by two or three; or, as in the case of some banks in Germany, five managers, and under them the active executive officers.

Senator NELSON. Would not five be sufficient?

Mr. VANDERLIP. I should see no serious objection to that.

Senator HITCHCOCK. Can you make any guess as to the number of employees such a branch would probably have?

Mr. VANDERLIP. The branches would, of course, be of different sizes. A number of employees are going to be required to handle the collections. That is a tremendously detailed work.

Senator BRISTOW. Why should it handle the collections?

Mr. VANDERLIP. That is absolutely essential, it seems to me, to the working of this plan, or any plan such as you have in mind. One answer would be because it will be a great economy to the commerce of the country, a great saving, a speeding up of the handling of collections, and in every way an economy.

If there is a much more significant reason than that. To handle collections banks have to keep deposits with other banks. That some of them are seeking to avoid, or, at least, seeking to make unnecessary. You will find country bankers objecting—until they come to understand this plan—to the fact that they must keep their reserves without interest in the Federal reserve bank or the regional banks, and they feel they must also keep about the same lines of deposits with their correspondents as they have before, because they do not grasp the significance of the collection feature. If the Federal reserve bank will undertake the collection business and will have the proper rediscount facilities, there is practically no reason for one bank to keep a balance with any other bank. Now, it is important that that should be done, for if you are going to compel the country bank to keep its reserve without interest, and still the exigencies of business compel it to keep a balance with a correspondent practically as large as it is already keeping, it works to the evident disadvantage of the bank.

Senator HITCHCOCK. The branches you provide for would have substantially the same functions as the regional banks under this bill?

Mr. VANDERLIP. Almost precisely.

Senator HITCHCOCK. Are you able to make any estimate of the number of employees such a branch would require?

Mr. VANDERLIP. That would, of course, depend almost entirely upon the size of the branch and the volume of the collections. I should think it would take easily several hundred employees in the larger branches.

Senator O'GORMAN. Assuming, under the pending bill, that New York City were constituted a single regional center, that we had one regional bank for New York City, have you calculated the probable number of employees such a regional bank would require?

Mr. VANDERLIP. I suppose the City Bank employs more than 100 men on that particular branch of business.

Senator O'GORMAN. Looking after collections?

Mr. VANDERLIP. The City Bank has about 14 or 15 per cent of the total deposits of all the clearing-house banks. You can see from that that a rough guess would be 700 men, or something like that. Of course that is a very offhand estimate.

Senator HITCHCOCK. One man handles, I understand, 1,500 or 2,000 checks a day. Is that right?

Mr. VANDERLIP. I am not sufficiently familiar with that detail to answer.

Senator BRISTOW. Why would it not do to let the country banks divide their reserves, and let them keep part of them, say, with the Federal bank—that is, make a smaller reserve requirement, and let them keep their deposits with commercial banks, as they do now, to such extent as they think desirable?

Mr. VANDERLIP. That is feasible, but I have presumed the point was pretty nearly settled that you wanted to take from the central reserve city banks the duplication of deposits which results from their holding the reserves of other banks.

Senator REED. That is the great danger in the present system, is it not?

Mr. VANDERLIP. No, sir; that is not the great danger—

Senator REED (interposing). Or, is it not one great danger?

Mr. VANDERLIP (continuing). I am inclined to think the present system is not as good a system as you would have with all the reserves in the vault or in the Federal reserve bank.

Senator BRISTOW. Now, suppose this were a bank of issue and could issue currency to meet a stringency or demand; could the evil which has resulted from the pyramiding of these reserves result after that system was once established? Could not the banks get the relief they desired so that there would be no trouble in these centers as a result?

Mr. VANDERLIP. I would not quite admit that the evil has come from this system of holding reserves; it has, in a measure. Either system—the one of the Government bank or the one you have been considering that has been passed by the House—will, I believe, obviate the recurrence of any such condition as, for example, in 1907, when it was a physical impossibility to supply the currency that was demanded by 25,000 frightened banks that wanted to build up their own reserves. There is the trouble. It is at the country bank end, not at the city bank end, that our system is defective. Of course, the two ends are related, but the trouble comes from the country bank becoming frightened—and by "country bank" I really mean all banks—and drawing to itself more reserve than it requires. What we want is mobilization of reserves—a reserve reservoir—and we want but one, and you will never get this thing just right until you get but one, either actually or in fact, or by relating the members you do have so they are in effect one.

Senator HITCHCOCK. What reserves would you require this Government bank to hold?

Mr. VANDERLIP. Perhaps it would be better for me to run through the plan and take these questions up in their natural order.

Senator NELSON. I should like to hear your reserve plan and your currency plan.

Senator BRISTOW. That would be better.

Mr. VANDERLIP. The earnings of the bank would—in the case of the Government subscribing to all the stock—first be devoted to an accumulation of a surplus of, let us say, 20 per cent. After that half to the accumulation of a further surplus and half to the Government, until the total surplus equals 50 per cent, after which all earnings would go to the Government. In the case of the public subscribing to the stock, the net earnings would first be devoted to paying the dividend, then to an accumulation of a surplus up to 20 per cent, then half to an accumulation of a further surplus and half to the Government, and after the surplus had reached 50 per cent all the remaining earnings to the Government.

I would devote all the earnings which the Government receives to the cancellation of the public debt, under specific terms which should be in the bill calling for tenders of bonds.

The customers of the bank should be only the Government and qualified member banks. Qualified member banks would include all national banks, and might include State banks and trust companies under proper restrictions of admission.

The Government should deposit all of its general fund with the bank and constitute the bank its fiscal agent.

Senator HITCHCOCK. Is there any objection to leaving that option with the Secretary of the Treasury?

Mr. VANDERLIP. I should think so. This is a Government institution solely, and the funds of the Government ought to be deposited there. Otherwise a Secretary of the Treasury might withdraw from commerce that entire deposit, which would, of course, be the principal deposit of the bank, and you might have the management of the bank and the management of the Treasury at loggerheads, and the bank could be broken.

Senator HITCHCOCK. What would lead a Secretary of the Treasury to do that thing?

Mr. VANDERLIP. I do not always know what leads Secretaries of the Treasury to do what they do.

Senator SHAFROTH. If these directors were long-time appointees, say 4 years, there might be an entirely different political party, and that might lead to a rupture.

Senator HITCHCOCK. Do you think the withdrawal of Government funds would seriously cripple the bank and possibly lead to its breaking?

Mr. VANDERLIP. I can readily conceive a condition of the bank where if you would draw \$150,000,000 or more of reserve money out of it the reserve would then be away below the legal limit, and this would lead to the bank's serious embarrassment, if not to closing.

Senator HITCHCOCK. Of course, you are providing a power to issue currency and a power to issue Government bonds.

Mr. VANDERLIP (interposing). But the Government bank could not pay its currency to the Government.

Senator HITCHCOCK. I understand you are giving the officers of the Federal board the power to issue Government bonds?

Mr. VANDERLIP. No power to issue bonds; no, sir. I do not understand the question—power to issue bonds?

Senator HITCHCOCK. Let me ask you this: You propose to give the Federal board the power to issue currency?

Mr. VANDERLIP. Certainly.

Senator HITCHCOCK. How do you propose to have that currency secured?

Mr. VANDERLIP. I will come to that in the regular order, if I may.

Senator HITCHCOCK. Would not that involve the power to sell bonds to get gold?

Mr. VANDERLIP. No, sir.

Senator O'GORMAN. The hour for adjournment has arrived, and we will take a recess until 2 o'clock.

(Whereupon, at 1 o'clock p. m., a recess was taken until 2 o'clock p. m.)

#### AFTER RECESS.

Senator O'GORMAN. I think we may resume, Mr. Vanderlip.

#### STATEMENT OF FRANK A. VANDERLIP—Resumed.

Mr. VANDERLIP. The reserve requirement for national banks I would have so changed as gradually to transfer the reserves from correspondent banks now acting as reserve agents, so that ultimately all reserves would be in the vaults of the member banks and in the vaults of the Federal reserve bank in the form of balances. The reserve requirement should be the same for all banks, country or city, because no bank would have any reserve responsibility to another bank, and there would be no reason why any one bank should be compelled to keep any larger reserve than any other.

Senator O'GORMAN. Do you suggest that what reserve ought to be?

Mr. VANDERLIP. I am inclined to think that a reserve of 12 per cent for all banks would be sufficient; and, in that connection—I reached that conclusion for this reason—I would recommend that the minimum reserve of the Federal reserve bank be 50 per cent rather than 33½ per cent—that it would be 50 per cent for all outstanding demand liabilities, including the notes that it might issue.

Senator WEEKS. The same reserve for notes would apply to all other forms of liabilities?

Mr. VANDERLIP. Yes.

Senator NELSON. Fifty per cent?

Mr. VANDERLIP. Fifty per cent for both notes and deposits. I would permit the board of the Federal reserve bank in an emergency to suspend the reserve requirements for 30 days and to continue suspension for periods of 15 days. The reserve bank would be empowered to rediscount for member banks paper of a self-liquidating character, to be defined by the act.

Senator NELSON. But there would be no member bank under this system, in the sense we have it in the bill?

Mr. VANDERLIP. No, not exactly in that sense; but there would be member banks. Perhaps a better term would be "depositing banks."

Senator O'GORMAN. Because that would be the only test.

Mr. VANDERLIP. The only test would be, Are bank depositors—are they permitted to deposit? All national banks would be depositors,

and State banks and trust companies might be, and all depositor banks should have the right of rediscount.

Senator POMERENE. You would have no qualification?

Mr. VANDERLIP. I would certainly have a qualification for the State banks. I will come to that in due order.

Senator POMERENE. But not so far as the national banks are concerned?

Mr. VANDERLIP. Every national bank must keep its reserve deposit as this law would indicate.

Senator POMERENE. Of 12 per cent?

Mr. VANDERLIP. Of 12 per cent, a portion in its vault and a portion with the Federal reserve bank. And, by the way, I should permit it to keep any amount which it choose to keep in the Federal reserve bank above the minimum that it must keep there. I would not make it keep in its vault any more than its needs require.

Senator NELSON. Five per cent out of the 12?

Mr. VANDERLIP. I would not have any fixed amount. I would let it keep as little in its vault as it could. For instance, a city bank doing a character of business that required very little currency would keep practically all of its reserve with the Federal reserve bank, knowing it could, at a moment's notice, convert its balance there into currency if it had a demand. Now, I would limit the amount that the depositor bank might rediscount. I think a fair limit would be the amount of its capital and surplus. I would permit the bank to go into the domestic market—

Senator NELSON (interposing). Excuse me, but you say you would limit it to that. You refer to discounts in general or discounts for the sake of obtaining currency?

Mr. VANDERLIP. Discounts in general, made directly on the application of the bank that is rediscounting. I would limit it to the purchase of paper in the open discount market that bore the indorsement of a bank. I would permit the bank to go into the open discount market and buy paper, but only paper that bore the indorsement of a depositor bank. In the foreign market I would permit a bank to go into the discount market and buy prime foreign bills without any regard to an indorsement by a depositing bank. The bank would also have to have the power to deal in gold coin and bullion and in the obligations of the United States Government, and probably of the insular possessions.

Senator HITCHCOCK. Suppose the Government had need of more funds? Would it have the right to borrow of the bank?

Mr. VANDERLIP. I should think it might have the right to borrow from the bank.

Senator NELSON. It ought to have that right?

Mr. VANDERLIP. It probably ought to have that right, but there would be something of a question. The bank is an instrument of the Government. The bank is wholly controlled by Government officers, by public officers. That is a question I would want to reflect on before giving an opinion.

Senator HITCHCOCK. In Germany, as I recall it, the Reichsbank loans to the German Government by buying short-time bills, but those representing the stockholders have the right to put a veto on it so as to limit the amount.

Mr. VANDERLIP. The trouble here would be that there would be no one who could put a veto on it.

Senator O'GORMAN. Why not? Why not have the reserve board exercise that power?

Senator HITCHCOCK. Because they are Government officials and do not represent the stockholders.

Senator O'GORMAN. It is true they represent the Government in the sense that they are Government officials. Yet their principal responsibility lies in a proper administration of this system, and power could very well be confined to them, notwithstanding the fact they are appointees of the President, to use their own judgment as to the extent to which the Government might procure credit in an emergency.

Senator NELSON. At all events, Mr. Vanderlip, excusing me for interrupting you, the loans to the Government should be short-time loans and not permanent investments.

Mr. VANDERLIP. That is exactly what I was about to say. In no event ought the Government to place its obligation with the bank where the maturity was more than a year. It must be banking paper.

Senator O'GORMAN. The Government would at all times possess the power it now has of getting money on its bonds—by issuing and selling bonds in the open market.

Mr. VANDERLIP. Always. Now, I come to a point that I regard as of the greatest importance, and one that has always baffled me heretofore in trying to see how a central bank, officered by public officers, could possibly be made to work. I think the question came up in the hearing I had here before. A central bank covering the whole country must have different rates of discount in different communities, else a community with a high interest rate will borrow all the funds of the bank before the community with the low interest rate reaches the point where it wants to borrow any.

Senator HITCHCOCK. Suppose you limit the amount that can be advanced to any bank.

Mr. VANDERLIP. Senator Hitchcock, you suggested in the hearing this morning a thought which I had never heard before in any discussion, and one that I have embodied in this bill, and which I thought was a new invention. I believe it is the most important thought that we have had on the line of a Government bank. It is this: I would have a uniform minimum rate of discount in every branch and for every bank, but that uniform minimum rate would apply only to a certain percentage of borrowing. If the individual bank is permitted to rediscount up to an amount equal to its capital and surplus, I would say that it may rediscount 30 per cent of that at the minimum rate. Then as it increased its rediscount above that, I would have a progressively increasing rate above the minimum rate. There you get the repressive measure where it belongs—not on the community but on the individual bank. You might have a community in which nearly all the banks were borrowing over the 30 per cent and paying more than the minimum rate, and one bank that had been running conservatively and borrowed nothing. When it came in the market, if the rates were different in the different parts of the country, it would be at a disadvantage. It would have to be penalized because of what its neighbors had been doing. Under

this plan the bank in a high interest rate community, where every one of its neighbors was paying more than the minimum, when there came need for it to borrow could borrow at the minimum rate up to 30 per cent of the total amount it could borrow, the minimum rate in the West being just as low as for New York banks, New England banks, or any other banks. That would be perfectly fair to every bank, and the minimum rate would apply everywhere throughout the country to every bank alike, and would be advanced as the individual bank's borrowing increased above, let us say, 30 per cent of the total.

Now, it was the discovery of that idea that brought me to the conclusion you could have a Government bank officered by public authority. Without that, this thing would be perfectly certain to happen: There would be political pressure from the community that was being charged a higher rate than some other community, and that political pressure would certainly move a public body, and you could not get the repressive action of the discount rate which you would be able to get by this very simple method. I was somewhat astonished and greatly pleased that you had arrived at that conclusion.

Senator HITCHCOCK. I am very glad to have your indorsement. [Laughter.]

Mr. VANDERLIP. As fiscal agent of the Government I would have the Federal reserve bank charged with the duties now imposed on the Treasury of the United States, and on the Bureau of Redemption in the office of the Comptroller of the Currency. I would transfer the present redemption fund which is now in the general fund—improperly in the general fund, because it is a trust fund—I would transfer that to this bank to be held as a trust fund, never as a part of its reserve, but to be held as a trust fund, and would charge this bank with the detail of redemption and the custody of bonds to secure national bank note circulation as long as that circulation is outstanding.

Senator HITCHCOCK. Of course, that would not add to the resources of the bank; it would simply be for economical reasons.

Mr. VANDERLIP. Yes.

Senator WEEKS. How much of a charge would that bank be permitted to make for that service?

Mr. VANDERLIP. I think it should not make any charge. The Government does not make any charge, and the bank ought properly, as fiscal agent, to assume that duty. Now, that is a suggestion. It is not an essential part of this plan, but it seems to be a sound suggestion.

I would authorize this bank to issue circulating notes. Now, there is the great difference and the great improvement that this plan would have over any plan that has been having your consideration, so far as I know. I think I said in my former hearing that I regarded the issue of these notes in the form of an obligation of the Government as wrong and as tending to lead to disaster, but that until it led to disaster that scheme would work. That I believe. But the more I reflected on it the greater emphasis I put upon the unwise of placing the Government obligation on the notes. Here anyone who holds the opinion that the people should control the

currency would find nothing contrary to that view by permitting this bank to make the obligation and to be solely responsible for the redemption of the notes. It would be the people. A bank wholly officered by public employees is the voice of the people, and that is the way the note ought to be issued—the obligation of the bank and not the obligation of the Government.

Senator HITCHCOCK. What would be back of the note of such a bank?

Mr. VANDERLIP. The note should be secured by segregating rediscount paper to the amount of 100 per cent, or one-year exchequer notes of the Government, to which I will refer later, and a 50 per cent gold reserve. Or the note might be secured by 100 per cent gold reserve.

Now, there might be conditions arise where there will be outstanding notes in excess of the amount of commercial paper the bank will have, but under those conditions the notes should be covered by 100 per cent of gold, and the bank should be perfectly free to issue its notes without limit so long as they are covered by 100 per cent in gold. There will be an actual flow of gold into the bank, and notes should be put out whenever they are demanded, and the bank's gold stock could always be increased in that way with 100 per cent gold covering notes outstanding to any extent.

Senator HITCHCOCK. You mean notes may be put out even when rediscounts are not coming in, simply because the banks are asked for currency.

Mr. VANDERLIP. Yes; but in that case they should have 100 per cent gold back of them.

Senator HITCHCOCK. The bank asking for currency may procure it either by depositing gold or drawing against their balances?

Mr. VANDERLIP. Yes.

Senator POMERENE. Then you have two distinct classes of notes?

Mr. VANDERLIP. No, sir; they would be exactly the same. The note must be covered either by 100 per cent of gold or by 100 per cent of rediscount paper.

Senator NELSON. With a reserve of 50 per cent?

Mr. VANDERLIP (continuing). Or exchequer notes and 50 per cent of gold.

Senator NELSON. Your reserve?

Senator HITCHCOCK. But to the extent that the notes exceed the discount paper, they must be covered entirely by gold?

Mr. VANDERLIP. Entirely with gold.

Senator POMERENE. You would expect those notes, redeemable then by the gold, to be practically the same as all gold certificates?

Mr. VANDERLIP. Yes.

Senator WEEKS. Would you make them legal tender?

Mr. VANDERLIP. I would not.

Senator POMERENE. Why?

Mr. VANDERLIP. Because they are, after all, a credit instrument. I see no reason whatever why a gold certificate, which is not a credit instrument, but a representative of gold, should not be a legal tender. I can not conceive any reason at all why it should not. But, parenthetically, I believe there are the strongest reasons why the size of the gold certificates should be increased. Gold in the form of gold certi-

ficates of \$10 and \$20 denomination ought not to be found in the pockets of the people. They ought to be in the bank reserves, and the thing in your pockets ought to be the note of the bank, always redeemable in gold.

Senator NELSON. You would have these new notes legal tender?

Mr. VANDERLIP. I would not, sir.

Senator BRISTOW. But you would make the gold certificates legal tender?

Mr. VANDERLIP. Yes.

Senator HITCHCOCK. Can you state briefly what evil might result from making them legal tender?

Mr. VANDERLIP. They are not money in any sense; they are a credit instrument; they are a promise to pay—they are a promise to redeem in money. They ought not to be made money, and no hardship can follow not doing so. It may be that there has been sometimes a case where a man presenting a national-bank note has met with the statement, "That is not legal tender, and I will not receive it." That case is so rare, if it ever did occur, that the point is negligible. Certainly the national-bank note was always convertible into legal tender, and, of course, the note of this bank always should be.

Senator HITCHCOCK. I understand, as an academic proposition, it is not sound or not wise or not legitimate to make them legal tender. But as a practicable proposition, I can not see what evil would result. Supposing it were done, just for the convenience of the people, what evil could result?

Mr. VANDERLIP. An obligation to pay is and ought to continue to be an obligation to pay money—to pay gold—not an obligation to give somebody's promise to pay gold. I do not think that is academic; I think it is real. On the other hand, I can see no objection at all to their not being made legal tender, because they will perform every function you want a circulating note to perform. I would give them every quality that the present national-bank note has. They should be received for public dues, and they should have all the qualities contained in the national-bank act in reference to national bank circulating notes.

Senator HITCHCOCK. I can see why they should not be made good for bank reserves, because then the gold might get away from the banks, which would be bad; but I have not been able to see why they should not be made legal tender. The man who receives them perfectly can get gold for them. I can not see that he suffers anything. Now, there must be some practical reason.

Mr. VANDERLIP. He does not suffer anything if he can get the gold. If he can not get it, he certainly ought not to be forced to take the promise to pay.

Senator HITCHCOCK. You are assuming that the note is always redeemable in gold.

Mr. VANDERLIP. If that is so, the note will always circulate as well as legal tender, except in the rarest possible instances.

Senator HITCHCOCK. I realize that, but is there anything that can rest it as a practicable evil by making them legal tender?

Mr. VANDERLIP. Yes. If by any chance this bank got in such a condition that it could not redeem those notes and reserve conditions were suspended, and it was not compelled to redeem them, just as the Government itself did not redeem its promises to pay for a great

many years, then to force a creditor to take that depreciated note, instead of the gold he is entitled to, would be an evil.

Senator NELSON. And they would be depreciated in price, as was the case of the legal-tender notes during the war.

Mr. VANDERLIP. Yes.

Senator O'GORMAN. They went down, I think, as low as 33 or 35 cents on the dollar.

Senator NELSON. It might not get as bad as that, but it would lead to depreciation.

Senator HITCHCOCK. Of course, those notes were issued without any gold reserve at all, without any provisions that are now made for safety. But I am still not able to see who would suffer or what evil would really arise by making them legal tender. They are legal tender, as I understand you to propose, when presented to the Government.

Mr. VANDERLIP. Because this is a Government institution.

Senator HITCHCOCK. Yes.

Mr. VANDERLIP. The Government ought to be ready and announce its purpose to receive them.

Senator HITCHCOCK. Therefore the Government, receiving them, can pay them out for any purpose. They are perfectly good.

Mr. VANDERLIP. It could not pay them for any purpose where its contract was to pay gold.

Senator HITCHCOCK. Those cases are rare, and the great volume of obligations could be made in them.

Mr. VANDERLIP. Nearly every corporation mortgage for the last 10 years has been made payable in gold.

Senator HITCHCOCK. They would not be affected, then; they would not suffer by making these legal tender?

Mr. VANDERLIP. They certainly might if they became depreciated and the income of the corporation was paid in the depreciated note, while the outgo was paid in gold. It would suffer very much.

Senator BRISTOW. Would making these legal tender have a tendency to have contracts made payable in gold more than would be the case if they were not made legal tender?

Mr. VANDERLIP. It would have a tendency. Contracts are now very largely made payable in gold when the amount is large and the period considerable.

Senator NELSON. Are these long-time railroad bonds payable in gold?

Mr. VANDERLIP. Almost invariably.

Now, on the subject of having those notes the obligation not of the Government but of the banks I heard a witness in this room this morning say that universities are teaching disloyalty to our Government. They are teaching history, and there never has been a case in history where the Government established a fiat obligation that that obligation did not go below par and usually lead to disaster.

Senator NELSON. Are you taking up the question of how to secure the gold for the redemption?

Mr. VANDERLIP. I am providing that they keep 50 per cent gold reserve.

Senator NELSON. Yes; but how is that gold to be acquired?

Mr. VANDERLIP. That will come in in the payment for the stock, in the deposits of the Government, and in the deposits of reserves by

all the depositing banks. That will not all be gold; that will be partly gold and partly legal tender. I think that part of the reserve which specifically covers the note might well be made gold—to protect a note redeemable in gold.

Senator NELSON. Would it not help us if we made the customs payable in gold?

Mr. VANDERLIP. No, sir; the customs in this case might just as well be payable in notes as gold, because they are going to be deposited right back into the banks. If the import dues were paid in gold, importers would draw gold out of the bank for it and it would come right back into the bank again.

Senator HITCHCOCK. Have you made any estimate as to the possible volume of these notes which would be issued?

Mr. VANDERLIP. A suggestion I am just about to make would operate at once, or as soon as would be practicable, to replace \$300,000,000 or \$350,000,000 of national-bank notes by these notes. Except from that I should doubt if in normal times there would be very many of these notes with the present level of business. In the crop-moving period I think there would be \$200,000,000 more. Then in future years, as the needs for currency expanded with growing business, the amount of these notes would expand.

Senator HITCHCOCK. Why would you retire \$350,000,000 of national-bank notes, when in your former testimony you expressed the opinion that our currency is not redundant at any time to an extent greater than \$150,000,000, as I recall it?

Mr. VANDERLIP. I would do that and keep exactly in accord with my former testimony. It was to the effect that if you did not retire some of the present existing national-bank notes there would not be room enough in our circulation for the purely elastic factor; that in normal times we have enough circulation. We would only, therefore, have to issue these notes for the peak of the load, and there might be none at all in the springtime, but only in the fall, in the crop-moving period. We ought to get some of these out of the way to make room for a note of an elastic quality. And then I would also provide the bank with a one-year exchequer note, as I explained in the hearing before. In a word, the plan would be this: Gradually, and over such period as the Federal reserve board may decide upon, the Federal reserve bank shall offer to purchase the 2 per cent bonds of the United States deposited to secure circulating notes of the national banks, at par, and up to an amount equal to one-half of such bonds deposited with the Treasury of the United States as security for national-bank note circulation. Now, it would pay for this by taking the redemption responsibility for the notes that are outstanding and would then exchange the 2 per cent bonds that it goes for the 3 per cent one-year exchequer notes.

Now, you may say at once that that represents a loss to the Government. But with the tax the bank would pay—and that tax to be a lie upon its earnings ahead of any dividends—an amount equal to  $\frac{1}{2}$  per cent on an amount of notes equal to these exchequer notes issued—that would compensate the Government for the payment of 1 per cent additional interest, and would compensate also for the loss of the one-half of 1 per cent tax now paid on circulating notes secured by 2 per cent bonds.

Senator POMERENE. Do I understand that tax to be on the exchequer notes you referred to?

Mr. VANDERLIP. The tax would be on circulating notes secured by exchequer notes.

Senator POMERENE. Yes.

Mr. VANDERLIP. I would gradually substitute rediscounted paper for the exchequer notes and leave them free in the treasury of the bank. This gives the bank an employment for its funds in normal times. In normal times there will be no great amount of rediscounts in this country. You remember the advantage of the rediscount system is not to employ all of your funds all the time in such rediscounts. It is not for a bank to borrow from this central reserve bank, and loan those funds at a higher rate to its customers. In normal times the bank will not go to the central reserve bank to rediscount at all.

The advantage is only that you can go there in the last emergency; that is the great advantage of it, that you can always go there; that you can always make your commercial paper liquid. Normally, the rate will be too high to go there. Normally, a bank will go into the open discount market and sell some of its commercial paper; or it may borrow through other banks. But the knowledge that it can always go there, can always make liquid its commercial paper, is the great thing.

Senator HITCHCOCK. I do not believe I quite get clear in my mind this process. You would have the banks take over \$350,000,000 of 2 per cent bonds now held in the Treasury for the various banks?

Mr. VANDERLIP. Yes.

Senator HITCHCOCK. Now, what would the bank pay for those?

Mr. VANDERLIP. It would assume the national bank notes now outstanding. That would be equivalent to paying par for the bonds.

Senator HITCHCOCK. Well, the national-bank notes outstanding belong to the banks of issue.

Mr. VANDERLIP. I know. Now, this bank would assume those notes outstanding that are secured by this \$350,000,000 of bonds.

Senator HITCHCOCK. It would assume their redemption?

Mr. VANDERLIP. Yes; it would assume their redemption and retirement.

Senator HITCHCOCK. And what would it redeem them with?

Mr. VANDERLIP. With its own notes, which it would be enabled to issue by putting these exchequer notes under the new circulating notes. Now, they would only remain under them temporarily. Ultimately commercial paper would come under them and the exchequer notes would be free in the Treasury. But, generally speaking, the \$350,000,000 of national bank notes would be replaced by \$350,000,000 of notes of the Federal reserve bank.

Senator HITCHCOCK. Well, the \$350,000,000 of 2 per cent Government bonds which would be taken over would be replaced then—

Senator O'GORMAN (interposing). Substituted.

Senator HITCHCOCK. Substituted by exchequer notes.

Mr. VANDERLIP. They would be absolutely retired by the Government. They would be received by the Government, and in their place the one-year exchequer notes would be issued.

Senator HITCHCOCK. And they would belong to this bank?

Mr. VANDERLIP. Yes.

Senator HITCHCOCK. And bear 3 per cent interest?

Mr. VANDERLIP. They would bear 3 per cent interest; they would mature every year; but the bank would be under obligation to renew them. They would renew them, probably, one-twelfth each month, or something of that kind.

Senator NELSON. But that right of converting 2 per cent bonds into 3 per cent exchequer notes, as you speak of, ought to be prorated among the banks, ought it not?

Mr. VANDERLIP. Oh, yes.

Senator NELSON. According to their bond holdings?

Mr. VANDERLIP. Certainly.

Senator NELSON. Otherwise it would not be fair.

Mr. VANDERLIP. It would not fair. Each bank ought to be permitted to sell one-half of its bonds that are up to secure circulation at par for this purpose.

Senator HITCHCOCK. But the Government would be paying 3 per cent on its bonds instead of paying 2 per cent. How do you compensate it for that loss?

Mr. VANDERLIP. By giving them the tax of  $1\frac{1}{2}$  per cent on the notes.

Senator HITCHCOCK. What notes?

Mr. VANDERLIP. The notes that the Federal reserve bank is to issue to retire the national-bank notes.

Senator HITCHCOCK. But you see that would be taxing itself, would it not?

Mr. VANDERLIP. It would be taxing itself, except that I say that the tax shall be a lien ahead of any dividends.

Senator HITCHCOCK. But, then, if the bank earns dividends any surplus over the dividends it is allowed to pay goes to the Government?

Mr. VANDERLIP. Then you might say, in effect, that it will be taxing itself.

Senator HITCHCOCK. So that you do not relieve the Government; and the Government would be paying 3 per cent interest instead of 2 per cent.

Mr. VANDERLIP. The Government would be taxing itself, in effect, if you could accomplish all the purposes that are sought to be accomplished, without doing this thing and make the earnings of the bank as high as they would be if you had not converted 2 per cent bonds into 3 per cent notes. But the earnings of the bank would really be materially higher as a result of converting bonds into notes; so much higher that the Government would profit instead of lose by making the notes bear 3 per cent.

Senator O'GORMAN. Would not the benefit that the Government would derive from the enjoyment from the surplus profits of this Federal reserve bank be more than ample compensation?

Mr. VANDERLIP. Very much more, in my opinion.

Senator O'GORMAN. For the immediate loss to which it may be exposed.

Mr. VANDERLIP. Yes, sir.

Senator O'GORMAN. In paying 3 per cent interest, where heretofore it has paid only 2 per cent.

Mr. VANDERLIP. Yes, sir.

Senator WEEKS. Have you made any estimate of how much that surplus profit would be?

Mr. VANDERLIP. I have not; but I feel quite confident that that would be the case.

Senator WEEKS. Do you think the dividends should be made cumulative?

Mr. VANDERLIP. Yes, sir.

Senator NELSON. With a 50 per cent reserve in gold, Mr. Vanderlip, could you not issue that currency based upon these exchequer bills in larger volume than the par value of the exchequer bills—than their face value?

Mr. VANDERLIP. I would not advise that, and I would not encourage the bank at all to use these exchequer bills as cover for circulating notes. The rediscounted paper is what should be used, and the exchequer notes should be held there in the Treasury for the employment of funds in a scant time. You see you pay 3 per cent on these notes, but to whom do you pay it? You pay it right back to yourself, practically, because the Government gets the earnings of the bank.

Then these exchequer notes become of the greatest value in influencing a gold movement or in protecting the bank in any time of stress. They would be perfectly ideal bankable paper in any commercial market in the world. With the highest possible credit and short maturity, they would be the ideal thing for a bank to have to operate with in the money markets of the world. The bank could go to the Bank of France or to the Bank of England or anywhere where there was credit to be had or gold to be bought and buy it with that obligation.

Senator HITCHCOCK. Well, as a matter of fact, would not they slowly drift out of the country, and would it not happen after 10 years that this bank would not have any of these choice 3 per cent bonds?

Mr. VANDERLIP. At the end of every year they come back into the hands of the bank. The Government pays them and issues new ones in their place, which the bank buys. They can not drift out of the country in the way you suggest. If they drift out of the country—that is, if the bank used them in order to buy gold, we will say, in London as soon as they mature—and some of them will mature in 30 days, some of them will mature in 60 days, and so on, and the last will mature in a year—they will at maturity be presented for payment and new ones at once bought by the bank.

Senator HITCHCOCK. Then, suppose the United States should become involved in war and it should find itself in a position where it had to market great quantities of bonds, would it not happen that it would not be able to renew these bonds on a 3 per cent basis?

Mr. VANDERLIP. The bank pledges itself for 20 years to renew them—

Senator HITCHCOCK (interposing). Oh, you have that in the charter of the bank, have you?

Mr. VANDERLIP. Yes, sir. That must be fundamental, that the bank is under pledge to renew them.

I would have this measure provide a national clearing house, as I explained this morning, and not alone for the reason that it would

be a great economic engine, but that you must provide for the collection of checks without imposing on banks the necessity of keeping balances with other banks.

Senator WEEKS. Mr. Vanderlip, that would be one of the most difficult things to do in this measure which you propose. Country banks—probably 22,000 or 23,000 out of the 25,000 believe that their interests are going to be jeopardized if that is done, and universally they have opposed any such action. Now, what can we do to prevent their making a material loss in revenues and still carry out the suggestion which you make?

Mr. VANDERLIP. Point out that they oppose it, not on economic grounds, which, if they understand it they must admit are sound, but on selfish grounds of earnings; and try to show them that if they will be broad gauged and put into operation a measure that will be for the best interests of this whole country, their earnings will be larger, although reduced by this small amount of profit which they make now on collections.

Senator O'GORMAN. Mr. Vanderlip, let me give you a concrete case. A gentleman representing the second largest bank in the State of Mississippi testified before us recently that the net profits of the bank amounted to \$40,000 a year.

Senator WEEKS. \$48,000, was it not?

Senator O'GORMAN. Perhaps it was. It was something over \$8,000, and he said \$20,000, almost 50 per cent of the net profits of the bank, were derived from exchange charges; and he said, in substance, that if a system were adopted by which their profits would be so materially reduced, that they would, of course, surrender their national charter, and continue as a State bank and continue to enjoy all at revenue. Now, what would you say to that?

Mr. VANDERLIP. I would say that I fear that these \$20,000 profits were gross. If you analyze exactly what he said, he probably said that he got \$20,000 in gross—he may not have used the word "gross"—in his collection charges. I can not believe that any bank that is doing anything like a normal business derives half of its net profits out of the net profits of the collection business. It is not so; that is all.

Senator O'GORMAN. We have been told by all representatives of country banks that their profits, perhaps on a capital of \$25,000 or less, might probably not exceed \$15,000 or \$20,000 a year—and that they may make as much as \$2,500 a year or \$3,000 from exchange charges.

Mr. VANDERLIP. A gentleman was making that statement to me the other day, and I challenged it; and he admitted that what he meant was that the gross profits out of collections were equal to one-half of his net earnings. Well, when you come to analyze that statement, the taking away of the collection business would not fall so heavily on that bank. If a bank is doing a business where half of its earnings come out of the community for paying collection charges, it is charging the community too much, and that community is paying too great a charge for that bank's services.

Senator WEEKS. Is it not true in the case of small banks of that kind, that about the same force would have to be maintained, whether they were doing this collection business or not; so that the receipts from the collection business are practically net?

Mr. VANDERLIP. Well, that might be, in some measure, true.

Senator WEEKS. In small banks?

Senator NELSON. Now, is not the situation altered somewhat under your plan from what it is in the bill, because there is nothing compulsory? That is, the country bank need not come into the system; they can stay outside and are not obliged to come in.

Mr. VANDERLIP. They must come in, so far as the reserve provisions are concerned.

Senator NELSON. Yes.

Mr. VANDERLIP. That is all. There is nothing else compulsory, particularly if you do not compel them to underwrite this public subscription of stock. There is nothing compulsory at all, except this reserve requirement; they must keep their reserve where you tell them to. That is all.

Senator NELSON. They need not do their clearances through these subsidiary banks?

Mr. VANDERLIP. Not at all.

Senator NELSON. So that the situation is not, practically, under your plan as it would be under the plan proposed in the bill?

Mr. VANDERLIP. Well, in effect this bank would do the clearing business so cheaply and so effectively that it would take it away from the other banks. The economy would be so great that that would be the effect.

Senator NELSON. Yes.

Senator HIRSHCOCK. I would like to have your opinion on this, Mr. Vanderlip. Suppose it is a fact, as I believe it to be, that there are possibly several thousand small communities in the United States which depend upon a bank, say, of \$10,000 capital, and that bank is a great convenience to that community, and it has, say, \$7,000 of deposits. It is not possible with that volume of deposits to have loans sufficient to pay a dividend upon the capital and a decent salary to the men that run the bank.

Now, they eke out dividends and their salaries by these collection charges. Would you not say that the bank is of sufficient convenience to that community to warrant the continuance of that system?

Mr. VANDERLIP. I would say that it is a great convenience to the community, and that under this plan it still would retain a considerable amount of what it makes out of collections. That is to say, a merchant in that community having a bill to pay in New York will come in to buy a New York draft under our present system. In order to sell a New York draft that bank has got to keep a balance in New York to write it on.

Under the system that I propose, or that is proposed in the bill that is before you, when a merchant comes in to get a piece of paper that will pay a New York draft the bank will merely write its check on the central reserve bank or, in the other case, on the regional bank. Instead of writing it on a New York bank it writes it on the central reserve bank or on the regional bank. It can sell it; it can get some charge, some commission, there just the same.

But its check on its deposit in the central reserve bank is par in New York or par anywhere else. It can write drafts for its customers that will be par anywhere in the United States, without keeping

the balance anywhere in the United States, except in the Federal Reserve bank.

Senator HITCHCOCK. Well, that is true. But it still is not getting well at it gets now. I understand a discount on such checks of its customers has come to it for collection. And now suppose that bank, not being able through a little charge on its drafts and through the interest on its loans to make living, to make an existence possible, goes out of business. The people of that community then go back to the idea of keeping their little hoards in stockings or in bedticks or under mattresses or they go 10 or 15 miles away and deposit it in a bank. Has not that community suffered a loss?

Mr. VANDERLIP. They have suffered a very great and very real loss if that were the effect, but that will not be the effect. The effect will be that that bank having the new facilities provided by either of these plans will prosper more, even in spite of this small loss, than it ever prospered before.

Senator HITCHCOCK. I think it is very questionable whether that bank gets any advantage out of this new system, however, which is proposed, because it has a privilege of discount now with its city correspondent, and its city correspondent might take paper which could not be available under the bill that we have before us or the one which you have, so that it gets no benefit at all.

Mr. VANDERLIP. The community in which that bank is operating will get a lower level of interest under either of these plans.

Senator HITCHCOCK. Well, I hope that will be the result, but I have never been able to see how such a bank gets any benefit out of this system.

Mr. VANDERLIP. If the community does get a lower level of interest rate, the community will prosper more.

Senator HITCHCOCK. But I think all these little banks will be wiped out. They do not exist in any European country where the centralized bank system prevails. You will find no such banks in France or in Germany or anywhere where that system prevails.

Mr. VANDERLIP. Personally I should be very glad, looking at the question from the point of view of the bank with which I am connected, to pass a measure that will compel the small banks of the country to keep deposits with us. My whole personal interest is on that side. But my judgment is that the advantage of the whole country lies on the side of the national clearing house.

Senator NELSON. Well, the little country banks, Mr. Vanderlip, not being required to keep deposits in other banks for exchange business as they do now would have more loanable funds at home, would they not?

Mr. VANDERLIP. Yes; and instead of getting 2 per cent for that balance as they now do they would get 5 or 6 per cent.

Senator NELSON. And that would compensate them in a measure for that small loss, would it not?

Mr. VANDERLIP. I believe it would compensate them fully.

Senator BRISTOW. Mr. Vanderlip, if Senator Nelson is through, I should like to ask you a question.

Senator NELSON. I have finished.

Senator BRISTOW. There is one feature that has been discussed a good deal since you were here the other day in regard to this exchange

matter, and that is the payments by check. Bankers do not like it, but the people do.

We have developed these small banks all over the country, and the country bank solicits from farmers and different citizens in its community and asks the people to deposit their money with it, and then to take a check book and pay out by check.

And I think that that has resulted—the use of checks in this country in the establishment and maintenance of a great many small banks, because it has drawn the money that was kept around in bureau drawers and other places in the community into a center; and instead of keeping the money in his pocket or hidden away somewhere, the citizen takes a check, and when he pay for any article of merchandise, or for a pig, or a cow he draws a check for it; he does not carry the money with him; the money is in the bank; and somebody has borrowed it that needed it; and so it builds up the community.

Now, the use of checks has become so common in this country that when a merchant in Salina, Kans., pays his Chicago house, he frequently—I say usually—simply draws a check on his local bank and sends it; it goes to Chicago, and they do not have to go and get a money order; they do not have to go and get an express order, or they do not have to go and buy a bank draft. The citizen does it at night, after everything is closed up. And in our part of the country the pay rolls are paid by check; everything is done by check. Now, with this discount system—not discount system—

Senator O'GORMAN (interposing). Clearing system.

Senator BRISTOW. Yes; clearing system that is suggested here; would not that break up or interfere with that process?

Mr. VANDERLIP. No; it would greatly facilitate it.

Senator BRISTOW. Now, tell me how it would facilitate it.

Mr. VANDERLIP. By facilitating the collection of the check. If that check reaches the Chicago merchant, he deposits it with his bank and is charged exchange on it. Anything that will facilitate the collection of that check is of advantage to the merchant, and therefore of advantage to the man who issues the check, because, in the end, that is where the cost must fall.

The merchant is not going to do business without profit. He is going to put into his pocket something to cover the loss of time and of commission in collecting that check. Anything that will facilitate the collection of that check will increase the use of similar checks.

Senator BRISTOW. Well, that is very satisfactory if it will operate that way.

Now, there is another advantage to the local merchant or the local citizen in our part of the country. Settlements are made the 1st of the month; and nearly all of the routine business is done and payments made the 1st of the month; collections are made the 1st of the month. The merchant on the last day of the month will go over his accounts. He knows what is due and where his check will reach the creditor on the 1st of the month; that if it does, he will get a discount probably. He collects on the 1st of the month. He draws those checks when he probably has not the money in the bank. His bank account may be low; it would not begin to pay them, and he depends upon his collections on the 1st or 2d day of the month to

meet those checks by the time they get back; and that is done everywhere.

Now, in the normal operations of the business of the country there are thousands and hundreds of thousands of men who handle their business in that way. And anything that we did here that would disturb or make difficult this routine-established method of business would be received with very great disfavor. And I do not want anything in this bill that we may pass here to in any way disturb that situation.

Mr. VANDERLIP. This measure will not facilitate the kiting of checks. It will not facilitate the business of writing a check when you have not a balance in the bank to pay it with. This will shorten the time between the blotting of your signature on a check and the time when that check is charged against your account; there is not any doubt about that.

Now, if you think it desirable for people to be able to write checks without having a balance in the bank, and let those balances come after a while, and increase the time between the day you sign the check and the day you are charged with it, you do not want this system.

Senator POMERENE. And the kiting of a check is neither fair to the banker nor fair to the payee of a check, is it?

Mr. VANDERLIP. No, sir.

Senator SHAFROTH. Mr. Vanderlip, how would it do to put a maximum charge of \$1 a thousand for collection?

Mr. VANDERLIP. I would not be prepared to answer that as to the figure. Certainly you do not want this bank to do a service without being paid for it. You do not want to impose on this bank the necessity of crediting in New York at par a check that has been drawn in San Francisco, and that the bank can not get its credit for until that check has traveled to San Francisco. You must permit it to charge what it is right to charge—what would be fair for the service performed—either a charge in the form of a commission, or in a delayed credit of the item—

Senator SHAFROTH (interposing). The only thing is, the country banks are protesting very strongly against this bill, and there is also some protest that excessive charges are made; and I thought that if you could put a limit upon it it might be a compromise that would be well to consider.

Senator BRISTOW. Mr. Vanderlip, suppose that I draw a check for \$1,000, living in Kansas, as I do, to pay a debt which I owed in Chicago—we will say to the Butler Paper Co. And that company deposits that check in a Chicago bank with which it does business, and that check is then sent back to the bank upon which it is drawn at Salina. The bank at Salina, Kans., does not charge me anything. It wants me to make my remittances that way. It prefers that I should do so. What charge is made—what bank gets the charges on that check?

Mr. VANDERLIP. I will tell you who does charge you something; that is, the Butler Paper Co.; because you have paid them with something that is not worth par; you have paid them with a piece of paper that they have to do one of two things with, either to put it in their bank and get a delayed credit for it, which means a credit after

some days, just to give the bank time to collect it, or be charged a collection commission.

Senator BRISTOW. Theoretically you are right, but practically you are not.

Senator O'GORMAN. You are a favored depositor there, Senator Bristow.

Senator BRISTOW. The Butler Paper Co. credit me with that check just the same as if it were a bank draft, or a postal money order, or an express money order; it makes no difference to them. I get exactly the credit, penny for penny, that I would even if I sent the money by express.

Mr. VANDERLIP. You will admit that it is worth less to the Butler Paper Co. than cash or a Chicago draft, will you not?

Senator BRISTOW. I do not know.

Mr. VANDERLIP. I can prove that it is, because I can tell you that they will not be able to get a par credit for that. They must pay a commission.

Senator BRISTOW. Well, I want to know what charges are made as against this check in its trip from Salina to Chicago and back again.

Mr. VANDERLIP. The Chicago bank will charge the Butler Paper Co. a commission. The Chicago bank will probably send that check to Kansas City and will pay nearly all of their commission to Kansas City. Kansas City will send it on to Salina, Kans., and probably has an arrangement with the Salina bank to remit once a week, so that the Kansas City bank will be out an average of four days. It must have charged a commission that will compensate it for interest. The Chicago bank must have charged a commission that will compensate it for interest, because it has credited this as cash to the Butler Paper Co. It does not get it back under a week. It is not cash, it is froth. It is a piece of paper in the mail. It will take a week to get that back from Salina, Kans., and perhaps more; a week to get it in the form of money in the vault of the Chicago bank.

The Butler Paper Co., has, however, obtained a balance that it can check on, and they must be charged a commission for collecting that piece of paper equal to the interest and to such work as may be connected with the collection, interest for the period from the time the credit is given to the paper company until the time the bank gets into its vault the equivalent amount of money.

Senator BRISTOW. As a matter of fact, the bank may charge the Butler Paper Co., and it may not. All banks do not make a charge for that.

Mr. VANDERLIP. I believe they do in Chicago. I believe there is a clearing-house rule there compelling all banks to charge.

Senator BRISTOW. Now we will take another illustration. Suppose that I have a customer at Plainville, Kans., who owes me \$100 and sends me a check on the Plainville bank in payment of that \$100, and I deposit the check and credit his account with \$100. When I deposit that check it is credited to my account for \$100. Well, as a matter of fact, that bank in the town where I live makes no charge. I never pay anything, and my Plainville customer never pays anything.

Mr. VANDERLIP. You pay something, and you do not know it. Senator BRISTOW. That is a very convenient way to pay debts.

Mr. VANDERLIP. You keep a deposit balance with that bank, else it would not receive that check and credit you with it at once.

Senator NELSON. Why?

Mr. VANDERLIP. And it pays you no interest on that deposit balance.

Senator BRISTOW. No.

Mr. VANDERLIP. And that is where you pay it.

Senator BRISTOW. Well, if this system were changed so that I could not do that, I would get no interest on the deposit anyhow.

Mr. VANDERLIP. The system would not be changed so that you could not do that. You could do all of these things. You could do everything you have been talking about here. The new system would only facilitate—it would only shorten the time, make the collection more rapid.

Senator BRISTOW. I do not object to shortening the time. I do not ask that this be artificially delayed. I think that it would be dishonest to artificially delay it. But I do contend that the system that has been developed by the small country banks for the purpose of gathering together the money in its vaults, so that the people can loan to the bank and the bank can loan it to the people, and take it out of the dark places where it does no good to anybody, and bring it where it can be used by the community—which is all the product of or which has resulted, rather, in the checking system—I think that anything that would destroy the check system or retard it would be injurious to the community and to the country as a whole.

And then its convenience is such that my sympathies have all been with the country bankers, because I felt that it was of great advantage to the country and that if these small banks had not been established, so as to gather together these sums and send them to the centers, we would not have anything like the banking system we have got now. And it is a wonderful convenience. And that is why I do not want to favor any exchange provisions here that will in any way interfere with that.

Mr. VANDERLIP. The bank is compensated by the proposed new conditions. They will more than compensate it.

Senator BRISTOW. So far as the checks of a bank are concerned, that was only of secondary importance, except as it might affect its earnings which are necessary, but I was primarily looking at the convenience to the community, and I know that if that convenience was taken away the measure would not be considered upon its merits; it would be regarded as an aggravation; it would be a source of great opposition.

Senator WEEKS. Is it not possible that the Butler Paper Co. might have sold to Senator BRISTOW a bill of goods at a slightly lower price if they knew they were going to receive cash instead of a check which would take five or six days to collect?

Mr. VANDERLIP. I think it possible; certainly if it were a large transaction.

Senator BRISTOW. I think the banks who get the use of this money absorb that charge, because they can afford to do it on account of the deposits they get, and the business men keep the deposits there because it is convenient to have them there. The banks absorb those checks, and what I suspect is that the big banks who feel the burden of those country checks would like to get out from under.

Mr. VANDERLIP. We get from \$200,000 to \$300,000 a year gross in charges.

Senator O'GORMAN. Exchange charges?

Mr. VANDERLIP. Exchange charges.

Senator BRISTOW. New York has the reputation of being pretty swift on exchange charges.

Senator O'GORMAN. I understand you are quite prepared to see a system adopted by which you will lose that revenue?

Mr. VANDERLIP. Yes, sir; because we believe we would get other advantages.

Senator HITCHCOCK. Would you materially reduce the force in your bank?

Mr. VANDERLIP. Yes; quite materially.

Senator WEEKS. I would like to call attention to a controversy which has been going on in the press between two usually well-informed men about the cost of this collection system, and I would like your opinion in regard to it. I do not remember the figures.

Senator HITCHCOCK. I have them right here. One man estimates the cost of such a system to be \$8,675,000 a year, and the other says that is about \$6,000,000 more than it should be.

Senator WEEKS. What have you to say about that, Mr. Vanderlip?

Mr. VANDERLIP. I am not a technical banker. I did not grow up in a bank. I know very little about the technical details of a bank. I am not prepared to express an opinion. I would suspect, perhaps, that here, as in many other cases, the truth will lie between the extremes. I am not prepared to express an opinion on that. I know the gentleman to whom you refer, and I have a very high opinion indeed of the technical knowledge of the one who makes the highest estimate. I am inclined to think he may be too high, but I would not undertake to demonstrate that without a study which I have not given to the subject.

Senator O'GORMAN. You may proceed, Mr. Vanderlip.

Mr. VANDERLIP. I would enlarge the charter rights of the national banks in order to permit them to compete successfully with trust companies that will be admitted to the system. That is to say, I would not put a premium on a national bank going out of the system, taking out a trust company charter and becoming a depositor of a Federal reserve bank.

The main expansion of charter rights should be to permit a national bank to have branches in the city where it is located, and to establish foreign branches, and to exercise general trust-company functions. That will prevent banks going out of the national banking system, taking out trust company charters, and becoming depositors in the central bank.

Senator NELSON. Let me see if I understand you right there. You speak of trust-company functions. Would you include in that the right, under proper restrictions, to loan on farm mortgages?

Mr. VANDERLIP. I would not, if I was personally writing the bill. Still I sympathize quite strongly with the view of western bankers, who find they can make a better loan on that kind of security, and who find that State banks are competing with them.

Senator NELSON. You must remember one thing, Mr. Vanderlip, and that is what a great thing those farm mortgages are for the big insurance companies.

Mr. VANDERLIP. Yes; I know.

Senator NELSON. They are a very great source of investment. The insurance companies prefer them to stocks and bonds.

Mr. VANDERLIP. As I have said before, I do not believe the provision in this act that is on the table is a dangerous one. I do not altogether like it, but I do not believe it is dangerous.

Senator WEEKS. You spoke of foreign banks just now. Have you come to any conclusion in regard to the amount of capital that would be required in order to establish a bank, for instance, in the Argentine Republic, to successfully compete with foreign banks there?

Mr. VANDERLIP. It would take a large amount of capital. They are used to seeing very large figures in the capitalization of banks there, although in that case the stock is not fully paid, as a rule. We have, and I think should have, no system of partly paid capital stock, and I think to successfully establish a bank in any South American country will require a showing of very considerable capital in order to compete with existing banks.

Senator WEEKS. About how much?

Mr. VANDERLIP. I would not think of anything under a million dollars. In Buenos Aires, I should think \$5,000,000 would be a minimum for a great American bank.

Senator WEEKS. That is, capital segregated for that purpose?

Mr. VANDERLIP. If you are going to segregate capital—I do not quite see the point of it. It seems to me that the honor, and really the credit of the whole bank, would have to be pledged to any branch of the bank.

Senator NELSON. Would it not do to have a branch in South America and in London, and have those branches with the power of what you call accepting houses?

Mr. VANDERLIP. They should have.

Senator NELSON. So that drafts could be drawn on those branches and accepted by them, and would not such drafts circulate like the European drafts?

Mr. VANDERLIP. Yes, sir; they would go into the open discount market then.

Senator NELSON. They would go into the open discount market in London and every other continental bourse.

Senator O'GORMAN. Mr. Vanderlip, have you any acquaintance with the banking requirements in different foreign countries where some of our national banks would establish branches under either of those plans?

Mr. VANDERLIP. I have made a wide study of South American banking conditions.

Senator O'GORMAN. Of course, you would expect that any branch of a national bank doing business abroad would continue to conform to the requirements of the national banking act?

Mr. VANDERLIP. Perfectly.

Senator O'GORMAN. As we may modify it. Suppose the local laws may have some requirements at variance with the requirements of our national laws. How would that conflict be met—because the natives of those foreign countries will have an interest in the maintenance of these banks; they will be doing business with our banks; they will be depositors and borrowers?

Mr. VANDERLIP. As a matter of fact, the laws are very generous in South American countries toward either branches of foreign banks or banks organized under the laws of foreign countries. Of course, you could not permit a bank organized under our laws to have branches in another country that would impose conditions opposed to the conditions you impose. They might impose conditions in addition to those; but you could not permit the establishment of a branch where the law of some other country would in anyway fundamentally change the impositions of our own laws.

Senator HITCHCOCK. Would the reserves be kept in this country?

Mr. VANDERLIP. They could not be entirely. That is a point that would have to be worked out. The whole subject needs very careful study, and is very lightly treated in the bill before you.

Senator HITCHCOCK. There is nothing in the bill that would indicate what should be done with the reserves?

Mr. VANDERLIP. No.

Senator HITCHCOCK. You are opposed to segregation?

Mr. VANDERLIP. I do not say I am opposed to segregation; but, as a matter of fact, I feel sure that the whole credit of the bank is pledged to the support of the credit of the branch.

Senator HITCHCOCK. Unless you have segregation and the branch be organized, the reserves would necessarily have to be kept in this country?

Mr. VANDERLIP. They would, and any till money that the branch kept would have to be in addition.

Senator O'GORMAN. Do you not think the laws of foreign countries would have to be very liberal which would permit the reserves of one of our branches in a foreign country to be retained in this country?

Mr. VANDERLIP. There are few countries that have any minimum reserve requirements.

Senator REED. Mr. Vanderlip, is not this question you are now discussing—the amount of reserves to be kept in a foreign branch—one that would almost necessarily have to be referred to the discretion of a central board of control, so that that board, within the exercise of its discretion, could prescribe the rules and conditions with reference to the reserves of such banks, and generally with reference to the transaction of their business?

Mr. VANDERLIP. I think it is, and I think it well could be with such a board as I have suggested here—a board absolutely removed from politics, made permanent, having continuity, and being of the character that I believe such provisions as I have suggested here would insure.

Senator NELSON. These foreign branches, would they be branches of this big central Federal bank, or would they be branches of our national banks?

Mr. VANDERLIP. Those are two entirely different subjects.

Senator NELSON. What have you been referring to?

Mr. VANDERLIP. I have been referring to our national banks up to this time. It is true that the Federal reserve bank itself ought either to have agents or branches in at least three of the European centers.

Senator NELSON. Ought it not to have branches there, through which they could make our acceptances over there?

Mr. VANDERLIP. I think, probably, it would have to be something in the nature of a subbranch. We have talked here of 12 branches and any number of subbranches, and I should think the foreign offices would be in the nature of subbranches.

Senator WEEKS. Is the National City Bank doing any business through such an agent at this time?

Mr. VANDERLIP. It is doing no business. The National City Bank has a resident representative in London. He does no actual business. I can he signs no paper; he is not an officer of the bank.

Senator NELSON. Does he make any acceptances?

Mr. VANDERLIP. Nothing of the kind.

Senator NELSON. What we need is practically an acceptance house abroad, is it not?

Mr. VANDERLIP. Yes; and we need the right of acceptance by national banks, and I would not limit that as in this bill to the acceptance of paper that arises out of the importation or exportation of goods. I would permit acceptances also in domestic transactions, and keep a limit to the amount of half—

Senator NELSON (interposing). And acceptances of finance bills, too?

Mr. VANDERLIP. No, sir.

Senator NELSON. Commercial bills?

Mr. VANDERLIP. Commercial bills.

Senator REED. What limit do you refer to?

Mr. VANDERLIP. Half the capital and surplus would be a fair limit.

Senator REED. What is the objection, if any, to banks dealing in exchange?

Mr. VANDERLIP. What is the objection to banks dealing in exchange?

Senator REED. Yes.

Mr. VANDERLIP. No objection in the world that I know of.

Senator REED. Foreign exchange?

Mr. VANDERLIP. The National City Bank is quite the largest dealer in exchange in the country, and I have never heard any objection to engaging in that business. It is essentially a part of the commerce of the country to handle foreign exchange.

Senator REED. When I say exchange—what is the objection to a bank dealing in acceptances with foreign banks, provided there is a reasonable limit; is there any sound objection?

Mr. VANDERLIP. There is no sound reason whatever, and there is a great advantage. It permits a bank which has the power of accepting to sell its credit, and it is a perfectly proper act for the bank to do. Under our present system you can not sell the credit of a bank. Its credit is only evidenced in the willingness of people to deposit money in it.

Senator O'GORMAN. The moment a bank gives its acceptance, it enlarges its liability?

Mr. VANDERLIP. Yes, sir.

Senator O'GORMAN. It is not contemplated that such a liability is to be taken into consideration in fixing the reserve?

Mr. VANDERLIP. No; and therefore you limit the liability and hedge it about with collateral security. That is to say, collateral credit in the form of the liability of the drawer of the bill you accept.

Senator O'GORMAN. In other words, when you give your acceptance, if at the same time you obtain adequate collateral, you are really enlarging your assets, at least to the same extent you are increasing your liabilities?

Mr. VANDERLIP. Yes, sir.

Senator O'GORMAN. So the safety of the plan would depend upon the judgment employed in the acceptance of the collateral?

Mr. VANDERLIP. Exactly.

Senator HITCHCOCK. When you make a loan you increase your assets, do you not?

Mr. VANDERLIP. It is just the same except that it does not take the cash out of your bank. Some one else provides that, because they put weight upon your credit which you have added to the credit of the other man.

Senator REED. And the same character of judgment must be applied in making an ordinary loan over the counter as would be applied in issuing an acceptance or signing an acceptance. It is the same thing?

Mr. VANDERLIP. Just the same character, but perhaps a little more caution would be exercised in regard to an acceptance because it runs longer than the average loan. An acceptance might run for six months, while the average loan of city banks is less than that.

Senator NELSON. A good many of these bills are drawn upon the proceeds of the bills of lading which accompany them, and that amounts to a security accompanying the bill, does it not?

Mr. VANDERLIP. That is a direct collateral security.

Senator NELSON. That is a direct collateral security in the very highest grade of bills?

Mr. VANDERLIP. It is typical of the right kind of loans a bank should make.

Senator WEEKS. As a result of your investigations in South America, if proper provision were made in this bill for establishing branches, do you think you would divert any of your capital to that purpose?

Mr. VANDERLIP. There are great difficulties in the way. There is, unquestionably, a profitable field there, and merchants of the United States would be greatly aided by the establishment of American banks. The greatest difficulty lies entirely outside of any legislation. It lies in the inability to get men of the right type who will learn the language, and who will become residents among the people, and who will absent themselves from the country. I have become almost convinced that it is, at the present time, so difficult that at least the establishment of South American branches is going to be a slow process.

Senator WEEKS. Do commercial houses have any difficulty in getting men for that purpose?

Mr. VANDERLIP. They do.

Senator HITCHCOCK. If a bank should keep a reserve against a note which it issues, why should it not keep a reserve against an acceptance which it gives?

Mr. VANDERLIP. Because an acceptance is not a demand obligation; that is, it is an obligation maturing at a fixed date. Why should you keep a reserve against that any more than against loans?

Senator O'GORMAN. You may continue, Mr. Vanderlip.

Mr. VANDERLIP. I would permit State banks and trust companies to be admitted to membership by conforming to the same capital, reserve, and examination requirements which national banks are obliged to meet in similar localities. The Federal reserve board should have the power to examine any member bank, and should examine a State bank before it was admitted to the advantages of the system.

I would make the circulating notes of the Federal reserve bank a first lien upon all its assets, and I would make—

Senator NELSON (interposing). Prior to dividends?

Mr. VANDERLIP. Prior to deposits, absolutely a first lien on everything, and depositors could not be paid off until the circulating notes were paid. I would protect the innocent holder of a circulating note, absolutely. Then, in turn, I should let the Federal reserve bank have the first lien upon assets of member banks for any indebtedness due from the member banks. This central bank must not lose money on bad loans. You would, by that method, give it not only the rediscounted paper but you would give it a first lien beyond that if some of the rediscounted paper proved bad. If it proved bad you have recourse to the first lien.

In respect to the rate of dividend that you would have to pay in order to float the stock at par, if you will exempt that dividend from all taxes which it is feasible to exempt it from—I am not a lawyer and I do not know how far you could go on that—that would be, of course, helpful in enabling you to float the stock at a lower dividend rate than otherwise.

These are the general heads of what I believe would be an economically sound scheme for a bank entirely controlled by the Government, and I believe it would be acceptable to the bankers of the country, after they came to understand it. I am not at all sure—

Senator HIRSHCOK. (interposing). You did not make any statement of the subject of bank reserves since luncheon, did you?

Mr. VANDERLIP. I believe I discussed that before luncheon; but I would have a uniform reserve requirement for national banks. That reserve, of course, would have to be kept either as a deposit balance or as cash in the vaults; rather, it would have to be kept as both, and I would permit a national bank to keep any part of the reserve which it saw fit with the Federal reserve bank, but would compel it to keep some minimum amount.

Senator HITCHCOCK. Do you think that a bank which itself acts as a reserve agent for country banks should keep a larger reserve than that bank which does not?

Mr. VANDERLIP. I know it should.

Senator HITCHCOCK. What would you fix the reserve to be?

Mr. VANDERLIP. I think probably 12 per cent would be sufficient, if you increased the reserve to be held by the central reserve bank. If you left that reserve at 33½ per cent and dropped the reserve of all national banks to 12 per cent, there would be too much capacity for expansion. I would make the Federal reserve bank keep a minimum of 50 per cent reserve.

Senator NELSON. For notes and deposits?

Mr. VANDERLIP. For notes and deposits both.

Senator O'GORMAN. Mr. Vanderlip, why do you propose that the central reserve banks should have 12 agencies? How do you fix on the number as 12?

Mr. VANDERLIP. I only fixed on it because presumably a great deal of thought has been given to the subject, and 12 was fixed on by the measure before you, and that seems to me about right.

Senator O'GORMAN. Would you be prepared to recommend that the number of agencies be left to the discretion of the Federal reserve board?

Mr. VANDERLIP. I would. I should say it would be wiser to fix the exact number in the first instance in the bill and leave it, after one or two or three years, to the discretion of the board to increase or decrease that number.

Senator O'GORMAN. Mr. Vanderlip, is there any substantial difference between the plan which you suggest and the plan described in the pending bill, excepting that you have revived a method of creating a banking system without requiring the qualifying banks to furnish the capital?

Mr. VANDERLIP. I believe there are most fundamental differences, and one that is of more importance than any other is the fact that you have made the bank note the obligation of the bank and not unnecessarily and dangerously added the obligation of the Government.

Senator O'GORMAN. Even under the system proposed in the pending bill, that is still an open question.

Mr. VANDERLIP. Of course, I can only talk to what the pending bill is.

Senator O'GORMAN. Yes.

Senator HITCHCOCK. You say that is the obligation of the bank?

Mr. VANDERLIP. Yes, sir.

Senator HITCHCOCK. Can you conceive of the possibility that a bank officered entirely by United States officials appointed by the President would default on its obligations and those obligations not be assumed by the National Government? Would not the National Government be morally responsible for them?

Mr. VANDERLIP. The National Government might ultimately assume those obligations. I am not altogether sure. I do not think the National Government has thus far shown to a certainty that it is going to discharge its obligations against the 2 per cent bonds, and the public does not think so; if it did, the bonds would not be selling below par.

Senator REED. Mr. Vanderlip, say the Government sold a 2 per cent bond to A B; it agreed to pay him 2 per cent interest, and it has done so. It agreed that it would pay that bond at a given date, and that date of maturity has not yet arrived.

Senator SHAFROTH. It will be 1930.

Senator REED. How can you justly say the Government has defaulted in its obligations?

Mr. VANDERLIP. I do not say the Government has defaulted in its obligations, but I do say that it has not, as yet, indicated to a certainty that it is going fully to fulfill its obligation.

Senator REED. What is its obligation?

Mr. VANDERLIP. Its obligation, presumably, is to leave a free field for circulating notes to the national banks who buy these very low interest rate bonds for the purpose of taking out circulating notes. You now propose to fill that field otherwise.

Senator REED. You are speaking about this bill, that we might in this bill do something—

Mr. VANDERLIP (interposing). Oh, certainly. It is the prospect as to whether you will or will not do the right thing in this bill that has set the bonds below par.

Senator REED. That is a very different thing from saying the Government has defaulted. What you really mean to say is that somebody has imagined that the Government may do something that will impair a utility that has been heretofore attached to these bonds, and that that gentleman, in anticipation of a general fall which may never come, has been around peddling his bonds for less than their face.

Mr. VANDERLIP. I would also say that nobody has imagined you would do something that would keep them at par and is therefore a buyer at par.

Senator REED. Of course, it is said that bankers are the most unimaginative people in the world. [Laughter.] And I suppose that is a good thing. Mr. Vanderlip, I am interested in one question here that I wish you would go into, even at the risk of repetition. It is proposed to establish, under this plan which you suggest, a Government bank. It is organized under a law to be enacted. It is to be officered, from president to janitor, by men appointed by the President of the United States. Its very activity and power spring from the Federal Government. It is to become the fiscal agent of the United States Government, and into its vaults every penny of money collected by the Government is to go. Now, that institution, created in that way, is about to issue letters of credit, if you please, and put them out to the people of the country as money. What reason is there that it should not make them good?

Mr. VANDERLIP. No reason under heaven, and you must be sure that they will make it good and not depend on some outside agency to do it.

Senator REED. Now, if the people must make it good, what is the difficulty about saying on the face of the note that the United States Government will make that note good?

Mr. VANDERLIP. Because it is no function of the Government at all to create a piece of fiat money and lend it to a banking institution. And if I can read history, there never has been a case where a Government has started in to create fiat money in that way that it has no, after starting on a sound principle, edged along toward an unsound principle and eventually found itself with its obligation below par and discredited.

Senator REED. I think we differ about terms. I want to ask you what you mean by fiat money.

Mr. VANDERLIP. I mean an obligation to pay on demand without having deposited in full the thing that you have agreed to pay.

Senator REED. Very well. I am not assuming now that this bank will issue a single note unless it has back of that note gold coin or gold bars or good commercial paper guaranteed by the member banks

and all the safeguards thrown around this currency that can be thrown around it. Now, you do not call that fiat money, do you?

Mr. VANDERLIP. Absolutely fiat. That only speaks for the credit of the borrower. The Government loans this note to the bank. The Government has no reserve back of it; it merely has looked well to the credit of the borrower.

Senator REED. Very well. You say that it fiat money?

Mr. VANDERLIP. Absolutely.

Senator REED. Now, the bank, under proper management, may want to issue a billion dollars of that fiat money, secured in that way. If the bank makes a bad disposition of it, disposes of it without proper collateral, of course the bank will go down. But it is proposed to make the conditions so that the bad disposition is impossible—

Mr. VANDERLIP (interposing). Then why add to a perfect note?

Senator REED. I ask you the corresponding question. If a failure is impossible, what difficulty is there about writing your name upon it?

Mr. VANDERLIP. There is no demand on the part of anybody who will take that paper to have the name of the Government written on it. If there is any danger at all then the danger is a great one to the guarantor, and there is no demand for the guaranty; there is no necessity for it; you have created a good note. It will float on the characteristics you have given it, and you should not involve the credit of the Government by adding something that no one calls for simply because you feel that the Government should control the issue. Under the plan proposed the Government will control the issue, but the obligation will extend only to the assets of the bank.

Senator REED. Now, I propose to sell to you the promissory note of A. B., which I decline to indorse except without recourse, and yet I say to you, "There is no possibility of this note ever being defaulted." Mr. Vanderlip, is the only reason back of this argument the possible fact that the Federal Government may incur a loss by guaranteeing an absolutely sound currency?

Mr. VANDERLIP. No, sir; the reason is the Federal Government has started upon a course of issuing these demand promises to pay and loaning them to a bank. Started on that course, history tells us that the next step will be the creation of more money of the same kind for another purpose not so sound.

Senator REED. You are afraid, then, not so much of this system which you propose to inaugurate, with the modification I am now discussing, as you are that in the future the Government of the United States might issue other and different money upon other and different kinds of security?

Mr. VANDERLIP. That it may issue exactly the same kind of money upon a less security.

Senator REED. In other words, the bank board of seven men which you propose to create might, simply because the Government created the note, proceed to let those notes pass out with less security than they would if the Government had not created the note?

Mr. VANDERLIP. That is not the point; not that that bank board will not care for the credit of that bank, but that there will come a demand, if you are willing to create this fiat money and lend it to this

central bank, that you next create some more of it and lend it to the shippers of wheat and the growers of cotton, to whom you will——

Senator REED. I catch your point. You are afraid that the mere fact that the Government guarantees this money would lead to the demand that the Government guarantee other and different money. That would be a very different proposition.

Mr. VANDERLIP. History is full of just such instances.

Senator REED. I know; but, Mr. Vanderlip, history is full of every kind of wildcat banking. History is full of every kind of failure in government. The history of the world shows that there never was a Government set up that did not end in a monarchy, and yet our fathers had the temerity to build a Republic. I want to know if there is anything economically sound except that, because I am very much interested in it.

Mr. VANDERLIP. No, sir. As I have said repeatedly, the plan in this bill will work just as well if the note be the obligation of the Government as it would if it were properly and soundly the obligation only of the bank, up to a point where the credit of the bank or the credit of the Government becomes involved, or, of course, up to a point where the Government will issue some more or similar notes for a dissimilar purpose.

Senator REED. Yes. Now, you propose, under your plan, to make these notes a full legal tender?

Mr. VANDERLIP. No, sir; I make them the same quality as the present national-bank notes. They are receivable for public dues, but are not a full legal tender.

Senator REED. Receivable for public dues?

Mr. VANDERLIP. Yes, sir.

Senator REED. That is, the Government must take them?

Mr. VANDERLIP. The Government must take them.

Senator REED. But private individuals not?

Mr. VANDERLIP. Yes, sir.

Senator REED. Now, will you tell me why a private individual should not take them?

Mr. VANDERLIP. Because if a private individual has made a contract to receive gold he should not be compelled to receive payment in somebody's promise to pay gold. Now, in the case of the Government, the Government would deposit its receipts with the bank daily in any event. It may just as well receive them in the bank's notes as in gold; whichever way it receives them, it would turn them that day into a deposit balance with the bank. By depositing the note the bank redeems the note.

Senator SHAFROTH. Why do you say, Mr. Vanderlip, that the contract is made for payment in gold, when we know when we can take those in United States notes there and compel the party to take those in liquidation of the claim?

Mr. VANDERLIP. I say that it is payable in gold. It is true you can compel the other party to accept something else, because you have made a law which says that something which is not money is legal tender. Because of that law you can compel a man to receive a thing that is not money. Now, that is wrong. However, it is the law.

Senator SHAFROTH. Do you not recognize that at the same time we have not a sufficient quantity of legal-tender money to act as reserves for national banks?

Mr. VANDERLIP. No, sir.

Senator SHAFROTH. Do not a stream of redemptions go to the Treasury every year to the extent of \$600,000,000?

Mr. VANDERLIP. I am happy to say they do; that is the proper function of the bank note. It should go to redemption.

Senator SHAFROTH. Then you think that is an advantage instead of a disadvantage?

Mr. VANDERLIP. Unquestionably; that is perfectly fundamental. A bank note that did not go to redemption would cease to perform its proper function.

Senator SHAFROTH. Did they go to redemption as much when there were fewer bank notes and proportionately a larger amount of legal-tender money?

Mr. VANDERLIP. I think the proportion of redemptions was about the same when the amount was very much smaller. Of course, it is true, and should be true, that if there is a greater demand for currency the bank note will not go to redemption so rapidly. That is what should happen and that is what happens in this case. That is to say, if there were a greater demand even for reserve money, the banks would collect reserve money from the public and it would be replaced by the bank note.

Senator SHAFROTH. And is not the member bank sending that money down here to Washington to get legal-tender money for it?

Mr. VANDERLIP. It is.

Senator SHAFROTH. And you think if there were more legal-tender money that would still continue? Would not the bank have actually more of the legal-tender money in circulation, and therefore would not have to send to Washington for it?

Mr. VANDERLIP. No; it would go on just the same. If you had more legal-tender money, if the bank reserves were redundant, the bank loans would be expanded just as certainly as any effect will follow a cause; and as the note came into the bank, not being available for reserve, it would then flow down here to be redeemed in legal tender. We always want more legal tender, because we will always expand our loans as long as we have legal tender enough to support the expansion.

Senator SHAFROTH. Mr. Vanderlip, if the State banks and trust companies come into this system, they will make a very large demand for more legal-tender money, will they not, to act as reserve?

Mr. VANDERLIP. That would depend upon whether the total reserve requirement were larger in this measure than is now required from State banks. That would not be the case in New York; it would be the reverse.

Senator SHAFROTH. But if the 18,000 banks that now have a right to keep bank notes for their reserves were to come into this scheme with the same requirement as national banks, of compelling reserves, would that not necessitate a great quantity of legal-tender money to act as reserve?

Mr. VANDERLIP. You mean to take the place of the bank notes that they now hold in their reserves?

Senator SHAFROTH. Yes.

Mr. VANDERLIP. I was told by the chairman of the committee at the last hearing that the total amount of such notes held by State

banks and in National banks was around \$80,000,000, as I recollect. It is not a large amount.

Senator SHAFROTH. Yes; but don't you see the State banks are not required to keep as large reserves, and if that requirement is made larger there will be a large demand for legal-tender money to act as reserves.

Mr. VANDERLIP. But I say the State banks with which I am familiar are required to keep a larger reserve.

Senator O'GORMAN. Of course, there are some States that do not require any reserve.

Mr. VANDERLIP. Exactly; but even if there were no reserve requirement you would probably find they would keep a reserve about as large as this provides.

Senator REED. Mr. Vanderlip, I confess that I still am unable to comprehend the real utility of a scheme which results in \$600,000,000 or the \$700,000,000 of national-bank notes being sent to the Treasury every year, redeemed at the Treasury, and immediately reissued. What useful purpose does that serve? That may seem a kindergarten question, but I want to get at it.

Mr. VANDERLIP. A bank note ought to be the currency in the pockets of the people, of course, ought it not?

Senator REED. The more we have of small currency in the pockets o' the people, I presume, the better.

Mr. VANDERLIP. Not at all. You only want an amount in the pockets of the people that will facilitate their ordinary business. And, as I said, with much emphasis at my former hearing, that is a matter over which you have as little influence as any matter connected with the banking business. What we carry in our pockets is a fixed amount.

Senator REED. Very well.

Mr. VANDERLIP. Now, that amount will fluctuate—

Senator REED (interposing). Why should it be a bank note rather than any other note?

Mr. VANDERLIP. Because you want the reserve money to be in the bank to form a basis for credit. You want circulating in the hands of the people a note that will conform in volume absolutely to the needs of the people and will be wiped out of existence as soon as it is not in use in their pockets. As soon as it comes into the bank it should disappear. And you can not pay that note out again, as you say, unless there is a demand for currency. Frequently there is a little demand for currency and we are unable to get out our own circulation at all. That is the case through several months of the year in some years. You can not always get out circulation. You have an inflow of these notes for redemption that is much larger than the outgo of currency that is demanded, and you redeem the surplus—

Senator REED (interposing). Let us say that your bank has—how many million dollars do you have out in bank notes?

Mr. VANDERLIP. About \$3,500,000.

Senator REED. Very well. Those bank notes of yours are gathered up by other banks and sent into the Treasury for redemption?

Mr. VANDERLIP. Yes.

Senator REED. And pretty soon all your \$3,500,000 is wiped out and there has been sent out in lieu of it greenbacks, silver certificates, etc.

Mr. VANDERLIP. No. This is the point. There probably has been nothing sent out in lieu of it. There has been less demand for circulation in the pockets of the people.

Senator REED. Very well; it is retired?

Mr. VANDERLIP. Yes.

Senator REED. And you have not any money out?

Mr. VANDERLIP. Yes.

Senator REED. How does it get out again?

Mr. VANDERLIP. Then, when the people want more money, when we have crops moving, when we have to hire the labor for crop moving, and have that larger use for money, it comes out.

Senator REED. That is what I want to get at. How does it come out?

Mr. VANDERLIP. Because the banker in your State that is in a community where the farmer is going to use more money finds his reserves being drawn out, and he sends to St. Louis for currency, and St. Louis in turn sends to New York, and unless they ask for reserve money we will send them a bank note. The bank note gets right out into the hands of the day laborer—

Senator REED (interposing). And you send to the Government, saying you want some more money?

Mr. VANDERLIP. Yes, sir.

Senator REED. You say, in effect, "You have retired all our bank currency, and now we want it again?"

Mr. VANDERLIP. As soon as it is retired we get it again and hold it in our own vaults. We have to pay no tax on it as long as it is in our own vaults. When a demand for currency comes we ship it out, unless it is a demand for reserve money.

Senator REED. Now, you get \$3,500,000 from the Treasury to-day. You take it down and put it in your bank vaults and hold it there, and you have to pay a tax upon it—

Mr. VANDERLIP (interposing). No, sir; we do not, until we emit it.

Senator REED. Unless you emit it?

Mr. VANDERLIP. Yes, sir.

Senator REED. It goes around and circulates and gets into the banks in Chicago. The banks in Chicago send it down for redemption, and now it is retired. Immediately it is sent back—

Mr. VANDERLIP. Yes, sir.

Senator REED. And you either pay it out at once or lock it up until you need it?

Mr. VANDERLIP. We lock it up if our receipts of national-bank notes are larger than the shipments of money that need not be reserve money. Now, we are shipping money, we will say, every day, some of which must be reserve money, because we are asked to send reserve money, and some of which need not be reserve money. We are receiving national-bank notes every day. If the amount of our shipments is less than the amount of our receipts there is no point in getting out our own notes for these shipments. We might just as well pay out in these other notes and send the surplus down here for redemption.

Senator REED. Then, as I understand you, the whole question amounts to this: The method of redemption, plus the tax, is a means of limiting the amount of this currency which may be out. If you

had no tax you would draw your \$3,500,000, you would put it in your vaults, and you would lend it whenever you pleased. It would go out to circulation, other banks would keep it in their vaults, lending it when there was a demand made. But, in view of the fact that there is a place of redemption and that by sending it in a bank can thereby escape this tax, there is an incentive to send it in and have it canceled?

Mr. VANDERLIP. The great incentive is another one, however. The bank that sends it in does not thereby escape any tax. The motive for sending it in is to get reserve money. The bank has more currency than it can pay out. You can not pay out currency unless somebody wants it. It is not because you have a surplus of currency you are going to increase your loans. A loan is usually collected in the form of a deposit balance; it is seldom collected in currency.

Senator REED. But you must have a legal-tender reserve, so they send it in and exchange it for a legal-tender reserve?

Mr. VANDERLIP. Yes, sir; that is the motive back of the redemption of the national-bank note.

Senator REED. In other words, the Government with its funds has to continually furnish the reserves back of the national-bank money?

Mr. VANDERLIP. The Government is merely an agent. The national banks must first put up the money that the Government uses to redeem these notes. It is not Government funds at all that are going to be used to redeem the notes.

Senator REED. It is the money we got for the bonds.

Mr. VANDERLIP. Not at all; it is the money that is put up in the 5 per cent redemption fund. It always has to be kept there, and a ways does redeem all that comes in. We have to make that good daily; just as often as there are charges against it we are notified that our redemption fund is deficient and we must build it up. Our redemption fund is never exhausted.

Senator REED. If those bank notes were a full legal tender and could be used for reserves, there would not be any necessity for sending them in at all?

Mr. VANDERLIP. No; nor any limit to the expansive possibilities they would be made a basis for.

Senator REED. Except that the bank would have to buy Government bonds.

Mr. VANDERLIP. That would be the only limit.

Senator POMERENE. Mr. Vanderlip, did you discuss the question of the qualifications which you would require of State banks and trust companies in order to enter into this plan of yours?

Mr. VANDERLIP. In a general way, I would make the qualifications the same as for national banks, with similar limitations as to capital, as to reserves, and as to examinations. I would permit the Federal reserve board to make such other regulations as they found in practice necessary to make. I would always insist that that board examine a bank before it was admitted as a depositor, if it were a state bank.

Senator O'GORMAN. Then, in a word, you would permit the State banks to come into the system under such rules and regulations as the reserve board would establish?

Mr. VANDERLIP. I would; such a reserve board as I have suggested here. I would always emphasize the character of that board.

Senator O'GORMAN. Two of those essential requirements, however, would be that the State bank would comply with the national-bank requirements respecting reserve and the State bank would also, as you stated, deposit in this Federal bank?

Mr. VANDERLIP. Oh, of course.

Senator O'GORMAN. What is your suggestion as to the amount or extent of the deposit that would have to be made by a State bank? Would you leave that with the reserve board?

Mr. VANDERLIP. It should make exactly the same deposit as a national bank would make. It must have the same reserve requirements.

Senator NELSON. And the same capital?

Mr. VANDERLIP. The same capital as a national bank in a similar locality.

Senator O'GORMAN. What would be the requirement of a national bank with respect to deposits? I did not hear you state that.

Mr. VANDERLIP. That the national bank would keep a reserve of 12 per cent, of which at least 5 per cent must be kept on deposit with the Federal reserve bank.

Senator O'GORMAN. When you spoke, then, of deposits by national banks you had reference to the portion that would be deposited?

Mr. VANDERLIP. Nothing more at all.

Senator REED. There has been a great deal said here about the reluctance of banks to rediscount, and the figures compiled by the comptroller show that there is an astonishingly small amount of discounts recorded. What do you know about the custom of indirectly discounting paper?

Mr. VANDERLIP. There is such a custom.

Senator REED. To what extent do you think it is practiced?

Mr. VANDERLIP. I do not know. It is discouraged by leading banks. I believe the highest amount of direct rediscounts that the comptroller's reports have shown is \$109,000,000, which was reported last summer.

Senator O'GORMAN. Outstanding at one time?

Mr. VANDERLIP. Outstanding at one time. As a guess, I should think there might be \$30,000,000 of rediscounts that do not show.

Senator NELSON. What is the form in which those indirect discounts appear?

Mr. VANDERLIP. The form varies. A bank may induce a lending bank to buy certain commercial paper which it holds and give it a letter directing it to charge the borrowing bank's balance when that paper matures. Sometimes the bank will sell to its own directors commercial paper, and its directors will unite in making a loan, a bank showing no rediscounts. Those, I think, are the two most important methods.

Senator O'GORMAN. Why is that resorted to?

Mr. VANDERLIP. So as not to show a rediscount on the published statement.

Senator REED. Mr. Vanderlip, I was told of one bank that carries \$9,000,000 of bank deposits, the president of which stated they actually had loaned \$4,500,000 to the banks by what he called indirect discounts.

Mr. VANDERLIP. That bank was encouraging that sort of business. That is not a fair average.

(At this point, to enable members of the committee to vote in the Senate, a recess was taken, at the expiration of which the hearing was resumed.)

Senator O'GORMAN. Mr. Vanderlip, have you any further observations to offer?

Mr. VANDERLIP. I have gone through the details of the plan. I have no specific observations to offer, except possibly to try further to emphasize the essential differences between the plan I have suggested, or outlined, and the plan that is before you, as it has passed the House. I believe those differences are absolutely fundamental and make the differences between a sound and unsound piece of legislation. I should say there are three differences of vital importance:

The difference that makes the note the obligation of a bank and not the obligation of the Government I regard as of the greatest importance. I can not overemphasize my feeling in that respect.

The difference which permits of a single bank and of a single discount rate alike to all banks I regard as a difference of great importance, and one which gives much greater equity to this measure than to the other. It would be impossible to adopt this theory with 12 or any other number of various banks—this theory of a uniform discount rate. It can only be adopted by a central bank.

Senator HITCHCOCK. Will you permit me to interrupt you for a question? I intended to ask you some questions before we took this recess.

Senator BRISTOW. He was outlining the differences between this suggested plan, Senator, and the present bill. Suppose he completes that first.

Senator HITCHCOCK. Yes.

Mr. VANDERLIP. This measure will not be compulsory upon the banks unless you compel them to underwrite the stock, which you may do. But in that event, the compulsion would be not nearly so obnoxious, because the bank could sell the stock if it so desired. I think it is superior in that it would distribute the stock to a large number of people.

Senator O'GORMAN. Right there, if you will pardon me. Having in mind the dividend would probably be exempt from all taxation, do you care to modify the view you expressed this morning that it ought to be 5½ or 6 per cent?

Mr. VANDERLIP. I am inclined to think if the dividend is exempt from all tax and there is no double liability on the stock, you could float it at 5 per cent.

Senator HITCHCOCK. Now, you speak of the national banks or member banks underwriting this stock subscription.

Mr. VANDERLIP. Yes.

Senator HITCHCOCK. You would give them a monopoly of the initial purchase of this stock?

Mr. VANDERLIP. Exactly the reverse. I would give the public the monopoly, permitting the banks only to buy after the public had refused to take it.

Senator HITCHCOCK. Would you permit the public to take it at par?

Mr. VANDERLIP. Certainly.

Senator WEEKS. How would you allot it?

Mr. VANDERLIP. I would allot it first to the smallest subscribers, just as the Spanish War bonds were allotted, so as to get as wide a distribution as possible.

Senator WEEKS. At par? I understood you to say you would sell to the highest bidder.

Mr. VANDERLIP. That would be another view to take. In that event, of course, the stock would be allotted to the highest bidders, and you could not allot it to the smallest subscriber.

Senator NELSON. The fairest would be to make the dividend so fair and low that you would sell it at par.

Mr. VANDERLIP. I think that would be the fairer way, to sell it at par and then to allot to the smallest subscriber.

Senator HITCHCOCK. You would not exempt the dividend from this stock as far as the income taxes are concerned—the Federal income tax?

Senator O'GORMAN. If you say "all taxes" that would embrace it.

Mr. VANDERLIP. I would, if you deemed that feasible. That is to say, if you want to float this stock at the lowest possible dividend basis, then you will exempt it from all taxes. Any taxation you add would in effect make it necessary to pay a higher dividend rate. Whether the small amount of the income tax would make it necessary to pay a dividend above 5 per cent is a question.

Senator HITCHCOCK. Would not that be a direct inducement for wealthy people who would have a very high rate of income tax to pay, to invest in this stock and thus concentrate its ownership? And that is exactly what we do not want to do.

Senator O'GORMAN. You could place a limitation as to the number of shares any individual would be permitted to take.

Mr. VANDERLIP. That would be possible. There would be no point in doing that, as the stock has no voting rights in any way.

Senator HITCHCOCK. But you said it was very desirable to have this widely scattered among the people.

Mr. VANDERLIP. I think so.

Senator HITCHCOCK. In rather small allotments, as those are people who have difficulty in making investments; but if you exempt it from the income tax it would not affect many of them, because those people have the minimum of income. But it would be an inducement for the very wealthy people to buy this stock, because they might escape a 10 or a 5 per cent income tax, so, I think, it should not be exempted from the income tax.

Mr. VANDERLIP. There is no principle involved in exempting it from any tax. The only point in exempting it from a tax is to enable you to float it at the lowest dividend rate.

Senator HITCHCOCK. Have you any doubt that a 5 per cent Government stock of that sort would sell at par without any exemptions?

Mr. VANDERLIP. If you are perfectly sure of it, and will provide that the Government will take any unsold part, all right.

Now, the last and one of the very important points of difference I want to emphasize is the character of this board of management. I think I said at the last hearing, in answer to a question of Senator Pomerene, that I was not afraid of Government management; I was greatly afraid of inexperienced or partisan management. I believe

It insures a management that is continuous, experienced, and that will be free from partisan influence, and will be of a character that the banks can fairly trust. The long term, without any ex officio members, is of vital significance.

Senator HITCHCOCK. What limitation would you put on the power of that board as to the rate it would charge for the use of rediscounts?

Mr. VANDERLIP. No limitation whatever.

Senator HITCHCOCK. You would allow them to give this for nothing—give rediscounts for nothing?

Mr. VANDERLIP. It is inconceivable that a board that is sane would do that. They are governed by the reserve requirement. You do not need a law further than that. If they must have a minimum 50 per cent gold reserve, they would very quickly reach a point where they would have to raise the rate.

Senator HITCHCOCK. They might have a reserve of 60 per cent gold and yet refuse to discount, too.

Mr. VANDERLIP. They should never refuse to discount sound paper. They should make the rate as high as the necessities of their position dictate. They should never refuse to discount sound paper.

Senator HITCHCOCK. You place this absolutely in the hands of this board—the power to say what the volume of currency should be—subject to the demands of the business world?

Mr. VANDERLIP. Ah; subject to the demands of the business world. The board would have no influence whatever, any more than your enactment would have an influence, upon what the volume of circulation will be.

Senator HITCHCOCK. If it made a discount rate of one-half of 1 per cent, that would certainly greatly expand currency, would it not?

Mr. VANDERLIP. No, sir; it would expand the credits of the bank, but not the currency.

Senator HITCHCOCK. That additional credit of the bank after the reserve surplus of the deposits is exhausted would mean an increase in currency?

Mr. VANDERLIP. How can a bank get out any currency that is not needed for use in the hands of the people? Let us take a definite illustration. Suppose the National City Bank is a member and decides to rediscount \$10,000,000 of paper, can it get out any more currency as a result of that? It will have a credit; it will have a balance in the central reserve bank, but it can not make you carry any more currency in your pocket, nor can it make any customer of the bank take any currency because it happens to have a credit somewhere.

Senator HITCHCOCK. Let me put a case this way: Suppose a bank out West has reached its legal capacity, and borrowers come to it for additional loans, and it finds that by applying to a branch of the United States bank it can discount paper on a very low basis. It will make the loans, because the discount rate is so low as to enable it to make an adequate profit.

Mr. VANDERLIP. The discount rate of the Federal reserve bank will never be lower than the current rate that the depositing bank is loaning to its customers, presumably. It would be a very extraordinary condition under which you would find the discount rate lower than the current rate. The function of this bank is to be a place of last resort to go to after banks have found, because of

changed conditions, they have taken too much commercial paper. It offers a means to turn commercial paper into a liquid reserve.

Senator HITCHCOCK. Take your bank. Suppose there is a strong demand for money, and you have been loaning freely, obtaining 4½ and perhaps 5 per cent, and you reach a point when you want to discount some paper. Suppose they refused to discount for you at less than 6 per cent. What would you do?

Mr. VANDERLIP. We will discount at 6 if we find we are running below our reserve. We would not do it in order to loan at 5½.

Senator HITCHCOCK. Suppose they made a discount rate of 3 per cent, what would you do?

Mr. VANDERLIP. If they made a discount rate of 3 per cent it would be certain we could not loan at 5½ per cent. That situation can not exist, because our neighbors would also have a rediscount rate of 3 per cent.

Senator HITCHCOCK. If you could discount your notes at 3 per cent you certainly can accept those loans that come over your counter?

Mr. VANDERLIP. At 5½ per cent; yes. But water would run up hill as quickly as such a situation would exist. It can not exist.

Senator HITCHCOCK. Has not that been the history in Germany? Whenever abroad there has been a strong period of exploitation of business and industry Germany has been developing and her foreign trade has been growing; that the German bank has rediscounted heavily at the Reichsbank, and the Reichsbank has finally reached a period of expansion?

Mr. VANDERLIP. Has reached a period, undoubtedly, where it has a large amount of rediscounts, but has always sustained itself by advancing the discount rate until we have found the German banks borrowing in the New York market at times at 9 per cent. We have loaned to first-class German banks at 9 per cent.

Senator O'GORMAN. Do you expect, then, that this system of rediscount will be used by a member bank for the purpose of making new loans, or will it be devoted entirely to procuring the money to keep up the required reserve?

Mr. VANDERLIP. It will be its function to keep up the required reserve.

Senator O'GORMAN. Now, with that limited field of activity on the part of the Federal bank, will it be able to make this money that will be required for its maintenance and pay 5 per cent, if that be the dividend provided for, to the stockholders?

Mr. VANDERLIP. It will be able to employ \$350,000,000 at 3 per cent, less the 1½ per cent tax, and to loan \$350,000,000 circulating notes, as we have provided that amount of one-year Treasury notes. It will be able to go into the open discount market and buy paper indorsed by any member bank at whatever rate is ruling. It will be able to go into the foreign discount markets and buy prime bankers' bills at whatever rate is ruling there.

Senator HITCHCOCK. Would you explain how the bank can issue \$350,000,000 of notes? Perhaps you will let me ask some questions to develop it. You say a bank with 100 millions of capital?

Mr. VANDERLIP. Yes.

Senator HITCHCOCK. Suppose that is all put in in gold.

Mr. VANDERLIP. Yes.

Senator HITCHCOCK. You then propose that it shall take, we will say, over \$300,000,000 of 2 per cent bonds; and you say issue \$300,000,000 of its notes?

Mr. VANDERLIP. It will issue them as rapidly as the notes that the bonds are sustaining are retired; that is, as rapidly as an equivalent amount of national bank notes are retired.

Senator HITCHCOCK. Now, then, it must keep a 50 per cent reserve against those notes. How is it going to get that 50 per cent reserve?

Mr. VANDERLIP. It will have 100 millions of capital, presumably \$150,000,000 of Government deposits. I have not the figures in mind, but let us say four or five hundred millions of deposits of reserve banks.

Senator HITCHCOCK. It must keep, though, a 50 per cent reserve against the Government deposits and also against the other deposits.

Mr. VANDERLIP. Yes.

Senator HITCHCOCK. Now, then, what has it to loan in that case, if its capital is more than absorbed by the reserve required against the notes? The notes are \$300,000,000, and there will be \$150,000,000 reserve there, at the outset. If the Government deposits \$150,000,000, that would require another 100 million of reserve.

Mr. VANDERLIP. No; seventy-five.

Senator HITCHCOCK. \$75,000,000 in reserve; and if the banks deposit, say, \$300,000,000, that would require another \$150,000,000 in gold reserve.

Senator O'GORMAN. Did you not say the banks might deposit about \$6,000,000?

Mr. VANDERLIP. I should think they would deposit about \$100,000,000. The statement of the bank would be about this: It would have capital, \$100,000,000; Government deposits, \$150,000,000; and bank deposits, let us say, of \$400,000,000.

Senator O'GORMAN. Making a total of \$650,000,000.

Mr. VANDERLIP. It would have deposits of \$550,000,000, against which it would have to keep \$275,000,000 of gold. It would have \$75,000,000 of gold free.

Senator HITCHCOCK. How does it get that \$375,000,000?

Mr. VANDERLIP. Capital, \$100,000,000; Government deposits, \$150,000,000, and bank deposits, \$100,000,000.

Senator HITCHCOCK. How can all the banks—all the banks could not pay in that much gold. How could you require the banks to make their deposits in gold?

Mr. VANDERLIP. They would pay in that much gold—gold or lawful money. They might have to rediscount some. I am presuming, in setting up this statement of the bank, that on the start they all pay it in and rediscount nothing.

Senator HITCHCOCK. You have a need for \$275,000,000 in gold reserves right off.

Mr. VANDERLIP. Yes, sir.

Senator HITCHCOCK. Against your notes.

Mr. VANDERLIP. You have \$975,000,000 of free gold or lawful money.

Senator HITCHCOCK. You have \$375,000,000 cash?

Mr. VANDERLIP. Of cash.

Senator REED. You can loan that cash to the banks and rediscount paper with it?

Mr. VANDERLIP. Let us say you loan \$100,000,000 to the banks; then you would have \$275,000,000, and you would only need \$175,000,000 as a gold reserve against this \$350,000,000 of notes, and you will have \$100,000,000 of free cash remaining.

Senator HITCHCOCK. You figure it will not be necessary to procure gold in any way except through the sale of capital stock—

Mr. VANDERLIP (interposing). The deposit of the Government and the deposit of the banks.

Senator HITCHCOCK. And that that would procure sufficient gold for the initial issue of \$350,000,000 in notes?

Mr. VANDERLIP. Yes.

Senator O'GORMAN. Will interest be paid on Government deposits?

Mr. VANDERLIP. Oh, no; not under any circumstances would interest be paid. Now, Senator Hitchcock, if the bank did find itself short, it could sell some of these one-year exchequer notes either in the domestic market or abroad. They would be freed from segregation to secure the note issue as rapidly as the Federal reserve bank discounted for other banks and got rediscounts in hand to put under the note issue.

Senator O'GORMAN. Does any other Senator desire to ask any questions?

Senator BRISTOW. I have been very much interested in this, Mr. Vanderlip. I have been in favor of a Government bank, such as you have described, controlled by the Government, the stock owned by the people and not by the banks, which was entirely independent of the banks and in shape so as to serve the banks when they needed it, and that this service will be extended under conditions which the law prescribes, and any bank that complied with those provisions as outlined in the law should have the right to the aid which it needed in time of stress as a matter of right. I have been in favor of that because I believe it is necessary in order to maintain the democratic banking system which we have, so as to render all of the banks independent of any monopolization of credit. I do not think that there is that independence now that ought to have been. I do not agree with the opinion which you advanced in your last hearing, that anybody who had good security could get credit at the banks. I think that depends upon the interest of the bank, its depositors, and the directors, and if some one should come and want credit that came in conflict with the interests of some of the patrons of that bank that were powerful and had enough influence with it, it would be denied, not because it was not good but because it interfered with some other business. Now, naturally I am interested in the view—I know you are not for a Government bank, managed by the Government, for the same reasons I have indicated, which are reasons that prompted me.

Mr. VANDERLIP. I believe those reasons do not exist, and I challenge you to present a single case where there has been such a discrimination in any important way in New York. I never have heard of it. It may exist, but I do not believe it does exist, and I know that it does not exist as a general thing. But that is neither here nor there.

Senator Bristow. We had one gentleman before the committee yesterday who told us his story, which I believe to be substantially true in some particulars.

Senator O'GORMAN. Did you credit the whole of it, after Senator Weeks's statement?

Senator BRISTOW. No.

Senator WEEKS. I am sorry that the Senator from Kansas believed it, because I denied it explicitly.

Senator BRISTOW. The Senator from Massachusetts denied his statement as to one of the banks, but not as to the others.

Senator WEEKS. If the Senator from Kansas will recall, I asked the witness if the corporation of which he was complaining had any deposit in any banks where his deposits were, and he replied in the negative in each case.

Senator BRISTOW. I remember distinctly those questions, and I think they were very ingenious and plausible; but, nevertheless, I think the shoe machinery company is powerful enough to prevent a man from getting credit if it interferes with their business.

Senator WEEKS. I think that is likely, but I do not think it has ever been done.

Senator NELSON. Would you limit the deposit to banks?

Mr. VANDERLIP. Banks and the Government positively to be the only depositors.

Senator NELSON. And would you limit the discounts to the banks?

Mr. VANDERLIP. Unquestionably. I would permit them to have no domestic transaction that did not bear the indorsement of a member bank.

Senator NELSON. The deposits and discounts must all be carried on with banks and not individuals?

Mr. VANDERLIP. Yes, sir.

Senator POMERENE. Would you permit it to go out and buy securities of any kind?

Mr. VANDERLIP. No securities except the bonds of the United States and its insular possessions; and, really, the bank ought to have no obligations of that sort except short time ones. I would be quite willing to prohibit the bank having any obligation of any kind, even of the Government, which ran over a year, except the first issue of 2 per cent bonds, which would at once be changed to exchequer notes.

Senator O'GORMAN. You have alluded to some great differences between the plan you suggest and the plan embodied in this bill, and I think the Senators recognize the difference between the two plans. With respect to one, I want to see if I understand you correctly, and that is, while under the plan proposed by the pending bill the banks will have a controlling interest in each one of the proposed 12 regional banks—

Mr. VANDERLIP (interposing). They will elect six of the nine directors.

Senator O'GORMAN (continuing). Under your system, which you recommend and suggest, the banking interests of the country will have no representation of any kind, from the top of the system in Washington down to the most humble position in any one of the agency banks.

Mr. VANDERLIP. Absolutely none at all; no more than it has in the Treasury or in any other department of the Government.

Senator O'GORMAN. Every official would get his authority either through the President or through some one appointed by the President of the United States?

Mr. VANDERLIP. Yes, sir.

Senator O'GORMAN. Is there anything else to be asked of the witness?

Senator BRISTOW. Yes; I have a number of questions I wanted to ask. Continuing the matter which we were discussing, Mr. Vanderlip, it of course would be unnecessary for you and I to proceed into an argument as to the control of credits by these great institutions of the country. I think Mr. Moffitt, in the financing of his railroad, was handicapped by the banks of New York who refused him the credit he was entitled to, because of the powerful interests he was antagonizing, and not because he was not promoting a railroad that was just as good a railroad as those who were fighting him. And, I think, in my own State, that the railroad enterprises have been killed not because they were not good, sound, and economical, but because they interfered with the interests of the Santa Fe Railroad, the Union Pacific, the Southern Pacific, and other lines that run up there.

Mr. VANDERLIP. Do you regard the building of a railroad as a proper function for a commercial bank?

Senator BRISTOW. Banks that would be a part of this system finance railroads and handle their bonds and sell them. That is done by the banks that would be part of this system or any system that is created. But that is simply an illustration.

But if those are the reasons which have prompted me, that is to preserve the democratic independence of our banking system, which I think is the best system in the world, because it gives opportunity to men to go out into the banking business and make a success on their own initiative; and this is one of the fields of activity in our country that is not monopolized, except when you get into the larger matters of credit. And I want to preserve that democratic independence. Now, I was interested, therefore, in the reasons that led you, holding views so radically different from mine, to finally come to the same conclusion I do.

Mr. VANDERLIP. I would say that I never would have reached this conclusion, I believe, had it not been for the views you hold. I was profoundly influenced in my mind when I was before this committee the last time by what seemed to me a general opinion that tended toward this sort of a solution. I was given special impetus to study the matter by the opinions you expressed—not at the hearing, but afterwards—outlining almost exactly the plan that I have tried to explain—not in detail, but in a general form. It was the interest of yourself and of other members of this committee that has led me to put almost continuous study on this idea for nearly all of the time since I was last before this committee.

Senator BRISTOW. Do you believe that such an institution as has been outlined here would preserve the independence of our country banks—the 25,000 banks that are now doing an independent business?

Mr. VANDERLIP. I do.

Senator BRISTOW. Do you not think it is a very desirable thing that it should?

Mr. VANDERLIP. Extremely so.

Senator BRISTOW. Well, you say "loan only banks." Why not loan to individuals in order to establish the rate?

Mr. VANDERLIP. And then, after a while, have the Government issuing notes to individuals. There you go. [Laughter.]

Senator NELSON. And would not that, Senator Bristow, compete with your little country banks?

Senator REED. I suggest that the Senator from Kansas and Mr. Vanderlip have another private conference, so that we may derive still more benefit. [Laughter.]

Senator Bristow. Well, now, tell me the danger. I would like to know the danger of this bank discounting paper in the open market?

Mr. VANDERLIP. I can hardly conceive a greater danger to our whole Government than the creation of a Government organization which might loan directly to individuals. I can hardly conceive of there ever having been thought of such a machine for the control of politics or for the aggrandizement of a body of men than to put in their power such a great aggregation of capital as this and allow them to deal directly with individuals and to extend them credit.

Senator O'GORMAN. Do you think that bank would be overwhelmed with applications if that was done? [Laughter.]

Mr. VANDERLIP. I am quite sure it would. And there would be no relation of credit and deposit balance between the borrower and the bank such as we are establishing by law here—between the depositing banks and the central bank. Here we are requiring that the reserves shall be kept within the vaults of the banks themselves and in the vault of the central reserve bank. That is the very sinew that the central reserve bank has to loan. It is inconceivable to my mind that there could be safely created such a machine as this that would be permitted to deal directly with individuals.

Senator BRISTOW. You think, then, as I understand, that it would be very dangerous for a reserve bank, a bank created to serve that purpose, and thereby strengthen the independent banking system of the country—for it to go and loan that money to individuals; you think that would destroy the very purpose for which it was created?

Mr. VANDERLIP. Yes, sir.

Senator BRISTOW. And make it impossible to serve it?

Mr. VANDERLIP. Yes, sir; and be filled with collateral dangers.

Senator O'GORMAN. And discourage banks from entering the system if the accommodations of the central bank were to be extended to the public at large?

Mr. VANDERLIP. I have no conception of government that would permit the Government to enter into business in this way.

Senator O'GORMAN. I do not understand that Senator Bristow recommends this. He only wanted to get your views.

Senator BRISTOW. Well, I wanted to understand its dangers. It has been urged, you know, that it would be necessary or ought to be.

Now, I do not know whether I got a very clear notion as to the requirements that would be necessary for a bank to have in order to avail itself of the benefits of this central reserve bank. It would become a part of the Federal system and be under its protection and entitled to the aid which this bank could give. You would extend it first to national banks, then to State banks and trust companies, if I understood properly, provided that the requirements of the national bank and of the trust companies and of the State banks should be the same, so that they would all be on an equality.

Mr. VANDERLIP. The requirements as to capital, examinations, and reserves.

Senator BRISTOW. Yes; and you would modify the national banking law so as to enable the national bank so as to enlarge their activities in certain States so as to compete with certain State institutions and be on an equality with State institutions?

Mr. VANDERLIP. I would, so as to prevent national banks from going out of the national system, taking out State charters, and then joining this new organization.

Senator O'GORMAN. Right there, if you will permit me one question, that bears on what was asked by Senator Bristow: What would be done by the national banks that, for any reason would not care to come into the system, if it should be optional?

Mr. VANDERLIP. Any bank that refused to keep its reserves according to law would have to get out of the system.

Senator O'GORMAN. Then you would make it compulsory that every national bank would have to keep part of its reserves in this Federal bank?

Mr. VANDERLIP. I certainly would.

Senator O'GORMAN. So that, to that extent, it would be compulsory?

Mr. VANDERLIP. No more compulsory than the present reserve requirements.

Senator REED. Just about as much.

Mr. VANDERLIP. No; not nearly so much in amount as the present requirement.

Senator SHAFROTH. Mr. Vanderlip, how much money, under the system you have proposed do you think it would be safe to issue?

Mr. VANDERLIP. Just as much as you could cover with the proper sort of rediscounted paper and with a 50 per cent gold reserve; and always have, really, something more than 50 per cent reserve, because that would be the minimum permitted by law as a general reserve of the bank.

Senator SHAFROTH. Can you estimate about what, in your judgment, that would be—the maximum?

Mr. VANDERLIP. If the whole plan were adopted, there would first be \$350,000,000, which would replace an equal amount of national bank notes. At the present time I think there would not be over \$200,000,000 in addition to that, and that much only at the season of the year when there was a demand for the largest amount of circulation. With the growth of the country, with the development that would surely follow such a sound banking scheme, I can imagine that amount might grow to a very considerably larger volume. I would hope to live long enough to see it 1,000 millions.

Senator REED. Have you consulted or talked with other bankers or financiers about this plan of yours?

Mr. VANDERLIP. I have.

Senator REED. How have they received it?

Mr. VANDERLIP. With great favor. I have talked with very few.

Senator REED. How do you believe it would be received by the banks? Do you think they would accept it, or do you think we would have another "Boston convention"? I do not speak of that unkindly; but it was an opposition convention.

Mr. VANDERLIP. It is difficult for me to say how they would receive it at first. I think they would be somewhat shocked at the idea of

complete Government control. When they came to understand the safeguards that it is proposed to throw about that, the character of the control which would flow from the method of its appointment, its term of service, and so on, I believe that they would accept it with great favor. They certainly would be relieved from the compulsory features of the bill that is now before you. They would be relieved from this extremely unsatisfactory but necessary provision for forced loaning by one Federal bank to another. And more than everything else, they would be relieved, I believe, to find that the circulation was to be bank-note money and not a fiat obligation of the Government.

Senator REED. You spoke about requiring the banks to underwrite a portion or all of the stock, except such portion as the Federal Government might take. How would that be worked out, in a practical way?

Mr. VANDERLIP. In a practical way, the banks would be compelled to underwrite a prorata proportion, based upon the relation of an individual bank's capital to the total capitalization of all national banks.

Senator REED. How compelled?

Mr. VANDERLIP. By the act.

Senator REED. And then if they did not?

Mr. VANDERLIP. If they did not, they would have to get out of the system. Now, I do not recommend that plan, if you think you can float the stock to the public without it or if you are willing to have the Government stand in the gap and take any stock that the public should fail to subscribe for. There is no desire at all to have the banks do this. They would not regard it as a desirable thing to do. They would not want to retain the stock. And the only reason whatever for proposing such a scheme would be to insure the success of the public subscription.

Senator REED. As I understand your plan, you would first open the subscriptions to the public?

Mr. VANDERLIP. Yes, sir.

Senator REED. On a competitive basis, giving the preference to the smaller subscribers?

Mr. VANDERLIP. Yes, sir.

Senator REED. If, then, there was, by a given date, not enough offered you would then have a provision in the bill that at that time it would become the duty to take a certain proportion of these bonds?

Mr. VANDERLIP. Yes, sir.

Senator REED. And to pay for them at their face. Now, you spoke of underwriting.

Mr. VANDERLIP. I would not do it quite that way, because, if it became obvious that it was going to be a failure—if that subscription ran for 30 days and on the twentieth day it became evident that the public was not going to take stock and that the banks would have to do so—you might have a scramble right then to get out of the national system. I would compel them to make the underwriting obligation.

Senator REED. In the first instance?

Mr. VANDERLIP. In the first instance. I would compel them to agree to take all of that stock, provided the public did not take it; but they would get none of it that the public was willing to take.

Senator REED. Then you would provide, in this bill, that by a given date the national banks of this country must file with the Federal

Government an obligation binding each of them to underwrite—to accept that portion of these bonds which their stock bore to the entire amount of the capital stock—

Senator O'GORMAN. In the national banks.

Senator REED. In the national banks. And that in the event of their failure so to do, their charter should be arrested and their business wound up.

Mr. VANDERLIP. It would be equal to that.

Senator REED. If they did that, then you would further provide that the banks had so underwritten the Government would offer this stock to the general public, and so forth—we need not go into the details.

Mr. VANDERLIP. Yes, sir.

Senator NELSON. And that the banks could then only get what the public did not take.

Mr. VANDERLIP. That would be all.

Senator NELSON. I suppose in this plan you would adopt the same quality or the same rules as to the paper that could be discounted as there are in the bill before the committee, substantially.

Mr. VANDERLIP. Substantially the same.

Senator NELSON. The same quality of paper?

Mr. VANDERLIP. Yes, sir; self-liquidating paper—that is, paper arising out of commercial transactions.

Senator O'GORMAN. Mr. Vanderlip, Senator Weeks has a question or two he would like to ask you.

Senator WEEKS. Suppose we provided for the engraving on the notes of this reserve bank something like this—I am led to ask this question on account of your discussion of issuing a bank note rather than a Treasury note:

United States of America. National reserve bank note. This note is secured by a gold reserve equal to 50 per cent of its face value by Government bonds or commercial paper equal to its face value by a first lien on all of the assets of the reserve bank and will be redeemed on presentation at the reserve banks, or any branch thereof, or at the Treasury of the United States.

Would that be a bank note or would it be a bank note with the Government guaranty?

Mr. VANDERLIP. It would be a bank note with a Government guarantee of redemption.

Senator WEEKS. Do you think it would be unfair to arrange the guaranty of redemption—assuming that we provide in the law that the bank shall keep the Treasury properly supplied with funds to guarantee the payment of any notes that may be presented at the Treasury.

Mr. VANDERLIP. I do; unnecessary and involving the Government in a possibly dangerous obligation.

Senator WEEKS. Well, do you think that would be sufficient as I have written it?

Mr. VANDERLIP. If the Government redeems them, it is as great a danger as it would be if they were the obligations of the Government.

Senator WEEKS. Of course, we are going to provide that the banks shall provide the means for the Government redeeming the notes.

Mr. VANDERLIP. Very well, if you will so state on the face of the note.

Senator O'GORMAN. It would be stated in the bill that we pass.

SENATOR WEEKS. Yes; it would be stated in the law.

Mr. VANDERLIP. You ought then to state on the note that they will be redeemable by the Government, if the Government is in funds provided by the banks for the purpose. Then that would be all right. [Laughter.]

Senator REED. That would be worse than saying nothing. [Laughter.]

Senator O'GORMAN. Is there any other question any Senator desires to ask of Mr. Vanderlip?

Senator HITCHCOCK. I do not quite see yet, Mr. Vanderlip, where you are going to get your gold reserve.

Mr. VANDERLIP. I would like to figure that out with you.

Senator HITCHCOCK. I wish you would put in writing in the record the statement of how a bank would start in business when it had \$50,000,000 of Government deposits, bank deposits of \$300,000,000, and outstanding notes of \$300,000,000.

Mr. VANDERLIP. I should like to do that. I should like to ask if it will be helpful to put in the record the plan as I have it, very briefly outlined?

Senator O'GORMAN. If there is no objection, the paper now in Mr. Vanderlip's hands will be incorporated in the record. And when will you be able to send the memorandum desired by Senator Hitchcock, Mr. Vanderlip?

Mr. VANDERLIP. I shall hope to do so within 24 hours.

Senator HITCHCOCK. Mr. Vanderlip, the only means this bank would have for securing additional gold for a reserve as its business grew would be the use of these Treasury notes, would it not?

Mr. VANDERLIP. Of its obligations; it could sell its own obligations.

Senator HITCHCOCK. To whom?

Mr. VANDERLIP. To anybody who would buy them—any foreign money market. It could sell its obligations secured by rediscounted paper.

Senator O'GORMAN. I think that will be all, Mr. Vanderlip.

(The statement or plan referred to by Mr. Vanderlip is as follows:)

The Government is to grant a charter to the Federal reserve bank of the United States, with capital stock of \$100,000,000, the charter to extend for a period of 50 years.

The head office is to be located in Washington, and 12 branches to be located in the cities selected by an organization committee, and subbranches wherever designated by the head office of the Federal reserve bank.

As soon as practicable after the passage of the act the President is to appoint a committee of five, to be designated as the "Federal reserve bank organization committee." This committee will divide the country into 12 commercial districts, and designate one city in each district as the seat of a branch of the Federal reserve bank, and generally be charged with the responsibility of organization.

The stock of the Federal reserve bank may either be subscribed for entirely by the Government, with funds raised by the sale of bonds or offered for public subscription, the success of such subscription to be insured by requiring all national banks to be liable for the purchase of their pro rata proportion of any stock not taken by the public.

The stock shall have no voting power, and no rights of any kind shall attach to it except to receive dividends. There need, therefore, be no restriction on its purchase or sale or accumulation, either by banks or individuals.

The Federal reserve bank will be wholly under the management of a board of seven directors, to be appointed by the President, with the advice and consent of the Senate, with terms of 14 years, but the first board to be classified and the term of one director to expire each two years.

The bill should provide that the President will select men qualified by experience and training for the particular discharge of the duties imposed and make no appointments in order to prefer political rewards. At least three of the members should be recognized to have had wide financial and banking experience.

Appointments are to be distributed geographically so as to give due weight to the commercial sections of the country.

The President, with the advice and consent of the Senate, will designate one director as governor and another as deputy governor, and the governor, or in his absence the deputy governor, shall act as chairman of the board and be the chief executive officer of the bank.

Members of the board to automatically retire at the age of 70.

The board of the Federal reserve bank shall appoint for each branch an executive committee of seven members. The bill will contain the same general directive clauses as to their character as in the case of the board itself, including the provision that at least three of the members of the executive committee shall be recognized to have had wide banking and financial experience. The term of office of the members of the executive committee will be seven years, but in the case of the first members appointed they shall be classified so that one director shall retire each year. One member of the executive committee will be designated chairman and vice-chairman of the committee, or, in his absence, the vice-chairman, will act as chairman of the committee.

All actions of the executive committees will be subject to the approval of the board of the bank. Each executive committee will elect a president and other executive officers to conduct the business of the branch, the men filling those offices to have no official or financial relation with any other bank.

The earnings of the bank shall, in case the Government subscribes to all the stock, be first devoted to an accumulation of a surplus of 20 per cent, and thereafter one-half of the earnings will be devoted to a further increase of the surplus until it reaches 50 per cent, and the other one-half go to the Government. After the surplus has reached 50 per cent all the earnings will go to the Government.

In case the public subscribes to the stock the net earnings will first be devoted to paying a 6 per cent cumulative dividend, then to an accumulation of a surplus equal to 20 per cent of the capital, after which one-half of the earnings will go to the Government, one-half be devoted to the accumulation of a further surplus until the surplus reaches 50 per cent of the capital, and thereafter all the earnings beyond the dividend requirement will go to the Government. All earnings received by the Government will be devoted to the retirement of the Government debt.

The customers of the bank shall be the Government and qualified member banks, which will include all national banks and may include State banks and trust companies.

The Government shall deposit all of its general fund with the bank and constitute the bank its fiscal agent.

The reserve requirement for national banks will be so changed as gradually to transfer all reserves away from correspondent banks now acting as reserve agents, and after this gradual transfer has been fully accomplished all reserves will be held in the vaults of the member banks and with the Federal reserve bank. The reserve requirement will be the same for all member banks and shall be ultimately 12 per cent.

The reserve to be held by the Federal reserve bank shall never be less than 60 per cent of the demand liabilities, including note issue, in gold or lawful money.

The board of the Federal reserve bank may, in an emergency, suspend all reserve requirements for 30 days, and continue such suspension for periods of 15 days.

The Federal reserve bank may rediscount for member banks paper self-liquidating in character, to be defined by the act. It shall not rediscount for any one bank an amount exceeding the capital and surplus of such bank.

The bank may buy in the domestic market from member banks, nonmember banks, and individual self-liquidating paper under conditions to be defined in

the act, bearing the indorsement of a member bank, and may buy in the foreign markets prime banker's bills.

The bank may also deal in gold coin and bullion and in obligations of the United States Government and its insular possessions.

The board of the Federal reserve bank shall establish a minimum rate of discount which shall be uniform at all branches and subbranches, and which shall be changed from time to time as conditions demand.

While the minimum discount rate shall be the same at all branches and to all banks, that minimum rate will only apply to the rediscounts of a bank up to an amount equal to a fixed percentage of its capital and surplus; thereafter such bank shall be charged a progressively increasing rate upon discounts until said discounts shall have amounted to a maximum permitted by the act, fully equal to the capital and surplus of said bank.

As a special duty of the Government the Federal reserve bank shall be charged with the duties now imposed upon the Treasurer of the United States and the Bureau of Redemption in the Office of the Comptroller of the Treasury in respect to the custody of bonds securing national-bank notes and the redemption of such notes. The 5 per cent redemption fund now in the general fund of the Treasury shall be transferred to the Federal reserve bank as a special trust fund and shall be held intact and shall not count as a part of the reserve of the bank.

The Federal reserve bank shall be authorized to issue its circulating notes. Such notes shall be secured by the segregation of rediscounited paper, as described in the act, equal to 100 per cent of such notes outstanding or one year exchequer notes of the United States Government hereinafter provided for, and by a reserve in gold equal to 50 per cent. The notes shall have the same qualities as the present national-bank notes, shall be payable at any branch on demand in gold, and shall be the obligation of the bank. There shall be no restriction upon the issue of notes by the bank when the notes are fully covered by gold coin or bullion. It being intended that to the extent that the outstanding notes of the bank are not fully covered by gold they shall be secured by 100 per cent in rediscounited paper, or exchequer notes, and by a reserve in gold equal to 50 per cent.

Gradually over such period as the Federal reserve board may decide upon, the Federal reserve bank shall offer to purchase 2 per cent bonds of the United States deposited to secure circulating notes of national banks at par and up to an amount equal to one-half of such bonds deposited with the Treasurer of the United States as security for national-bank note circulation. It shall pay for these bonds by assuming the responsibility for the redemption and retirement of the national-bank notes secured by them. Upon acquiring these bonds the Federal reserve bank shall receive from the Government of the United States in exchange for the 2 per cent bonds an equal amount of one-year exchequer notes bearing 3 per cent interest. The Federal reserve bank shall give an undertaking to the United States Government that it will renew such exchequer notes each year at maturity for 20 years. These notes will be made to mature at various periods during a calendar year. So long as these notes are outstanding the Federal reserve bank shall pay to the United States, out of its earnings and before any dividends are paid upon the stock, a tax of 1½ per cent on an amount of circulating notes equal to the amount of exchequer notes outstanding.

The bill should provide for a national clearing house.

The charter rights of national banks should be so enlarged as to permit banks to have branches within the city in which they are located, to establish branches abroad and to exercise general trust company functions to be defined in the act.

National banks shall have the right to accept drafts of a character to be lettered up to an amount equal to one-half of their capital.

State banks and trust companies may be admitted to membership by conforming to the same capital, reserve, and inspection requirements that natural banks are obliged to meet in similar localities. The Federal reserve board shall have power to examine any member bank.

The circulating notes of the Federal reserve bank shall be a first lien on all the assets of the bank.

The Federal reserve bank shall have a first lien upon the assets of member banks for any indebtedness due from them.

As far as feasible the Federal reserve bank shall be exempt from the payment of all Federal and State taxes except taxes upon real estate. As far as feasible the stock of the Federal reserve bank and the dividends thereon shall likewise be free from all Federal and State taxes.

(Mr. Vanderlip, at the request of the committee, also submitted the following:)

WASHINGTON, D. C., October 24, 1913.

HON. ROBERT L. OWEN,

*Chairman Committee on Banking and Currency,*

*United States Senate, Washington, D. C.*

Sir: In compliance with the request made by the members of the committee at my hearing yesterday, I am sending you a statement of the Federal reserve bank after a transfer of reserves from correspondent banks.

Such a statement, of course, can not be made with accuracy, nor can any figures be compiled with accuracy that will show the effect upon the reserves and upon the deposits of national banks, as there are too many variable elements to be considered.

The statement of the Federal reserve bank might be as follows:

ASSETS.	\$
Cash from stock	100,000,000
Cash from banks	256,000,000
Cash from United States	150,000,000
Total	606,000,000
Exchequer notes	350,000,000

LIABILITIES.	\$
Capital	100,000,000
Government deposits	150,000,000
Reserve deposits	253,000,000
Total	606,000,000
Circulating notes	350,000,000

RESERVE REQUIRED.	\$
Against deposits	252,000,000
Against notes	175,000,000

EXCESS	\$
Total	428,000,000
	178,000,000

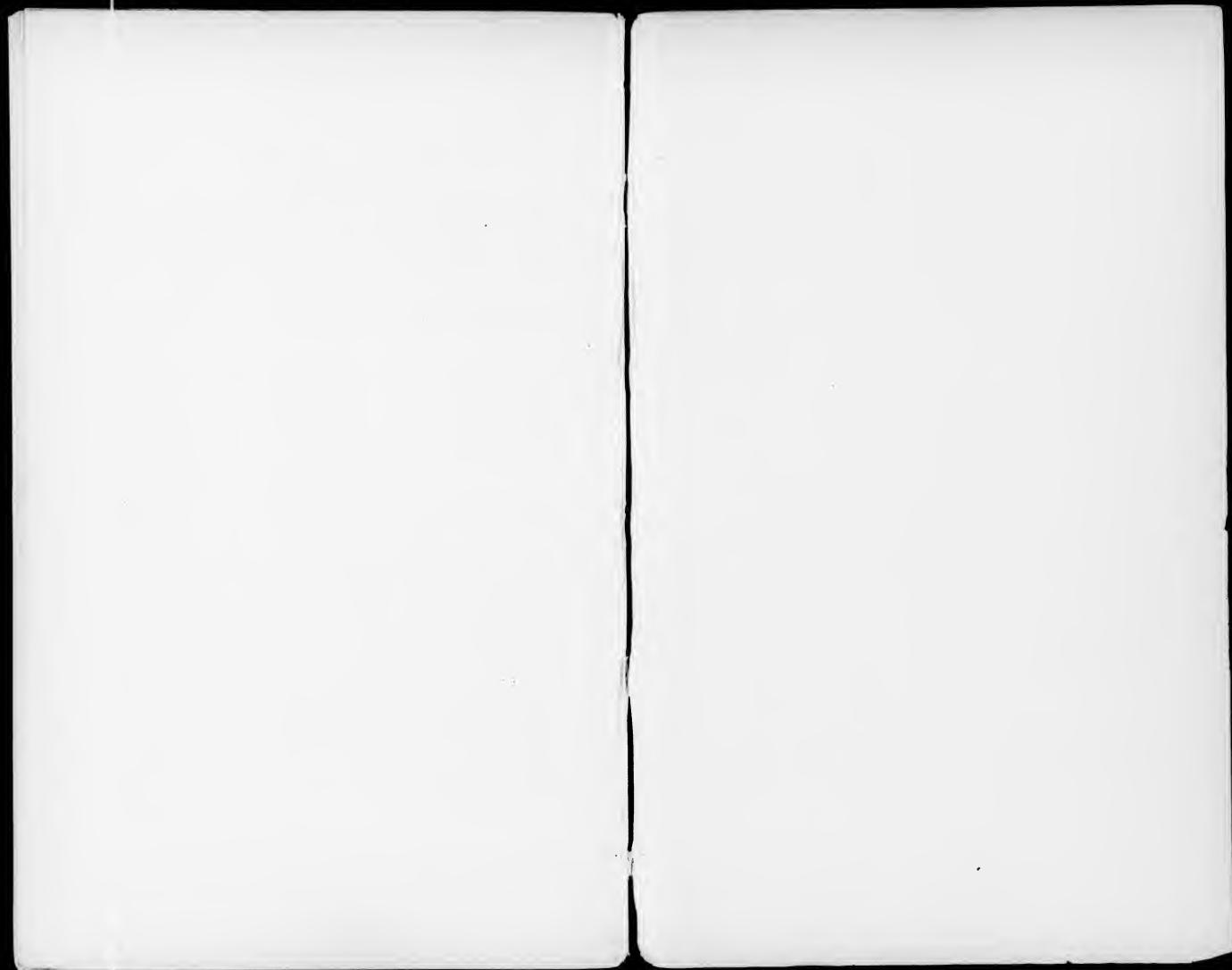
It will be observed that the bank's holdings of cash will be sufficient to provide the minimum reserve of \$253,000,000 against its total deposit liabilities, a minimum reserve of 50 per cent against \$350,000,000 of notes issued in retirement of an equal amount of national-bank notes, and still have in excess of \$178,000,000.

It is probable that banks in central-reserve cities and, perhaps to some extent, banks in reserve cities would find it necessary to rediscount at the Federal reserve bank in order to meet the drafts made upon them by correspondent banks removing their reserve balances. I would estimate that rediscounts of \$100,000,000 would permit that to be done without undue strain upon the banks of reserve and central-reserve cities. It is obvious that the transition from the present system to any new system which would impound reserves in the vaults of member banks and in the Federal reserve bank should necessarily be made slowly and with great caution, and it would seem to me desirable that the board of the Federal reserve bank should be given latitude as to the various periods during which this transition should be made.

The figures that I have used are based on the abstract of the condition of national banks in answer to the call of June 4, 1913, as I did not have the later abstract at hand. Figures made up from the later abstract would vary slightly, but in a general way the foregoing will indicate the possible position of the reserve bank.

Respectfully,

F. A. VANDERLIP.



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TITLE**